National Australia Bank

Embargoed until: 11:30am Tuesday 11 June 2013

Monthly Business Survey

May 2013

Business conditions remain at low levels (marginally higher) with unchanged mediocre confidence levels. Conditions better in wholesale, manufacturing and construction, but mining worsens (capex at record low). Near-term demand to stay weak with forward orders, capacity utilisation and employment conditions still well below average levels. Any confidence gained from falling dollar and May rate cut have been undermined by domestic weakness. NAB activity forecasts broadly unchanged – a touch lower in out years. Currency forecasts somewhat lower.

- While the business environment improved a little in May, overall business conditions remained weak with the still negative reading implying further sluggish monthly activity. Broad-based improvements in profitability, employment and trading conditions helped to lift business conditions in the month, though each of these indicators remained well below their long-run averages. Despite improvements in conditions of some weaker industries (wholesale, manufacturing and construction), mining slumped heavily in May in line with the general softness in commodity prices and the weakness in mining capital expenditure, which reached a new low in the May survey. Forward indicators suggest near-term demand will stay weak.
- Business confidence remained poor in May, with mining still very pessimistic. A lower dollar and the RBA's decision to cut the cash rate in May might have helped confidence in the month, but the weakness in the domestic economy appears to have provided some offset to this.
- Overall, the survey implies underlying demand growth and GDP (6-monthly annualised) of around 2½% in the June quarter. Our wholesale leading indicator suggests a modest improvement in near-term activity, at best.
- Labour costs growth edged higher in May, consistent with a slight up-tick in employment conditions. Prices (including retail) fell marginally, while modest growth in costs implies further compression of margins.

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

- The consensus view is that global growth should accelerate through 2013 as recessions end in Western Europe, Abenomics lifts Japanese growth, the US continues its moderate expansion and solid growth continues in the big emerging economies. So far data have not shown such a synchronised global upturn. We still expect global growth to be around trend next year but downside risks now more prominent.
- Evidence the slowing in labour intensive mining investment is well underway and weakness in gross national expenditure has led us to soften our medium-term GDP forecasts. We see GDP growth of 2.8% in 2012-13, softening to 2.3% in 2013-14. While a lower Australian dollar and rates should help to offset some of the impact on the Australian economy from structural adjustment, they will be insufficient to prevent unemployment from rising – we see unemployment exceeding 6% by the end of 2013 (5¾% previously) and remaining around 6¼% in the out years. We expect the RBA to cut again in November (with the lower currency giving the RBA time). However, stimulus could come earlier if the labour market weakens more quickly than anticipated. We have revised down our currency forecasts for the AUD/USD to 93c by end 2013 and 87c by late 2014 (FX Strategy).

Key monthly business statistics*

	Mar 2013	Apr 2013	**May 2013**		Mar 2013	Apr 2013	**May 2013**
	Net balance				*Net balance*		
Business confidence	2	-1	**-1**	Employment	-6	-7	**-6**
Business conditions	-7	-6	**-4**	Forward orders	-6	-6	**-5**
Trading	-5	-2	**-1**	Stocks	0	-2	**0**
Profitability	-7	-6	**-4**	Exports	-1	-3	**-3**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.8	0.8	**0.9**	Retail prices	-0.4	0.1	**-0.2**
Purchase costs	0.5	0.4	**0.5**		*Per cent*		
Final products prices	-0.1	0.2	**-0.1**	Capacity utilisation rate	79.9	79.5	**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 27 to 31 May, covering over 500 firms across the non-farm business sector.

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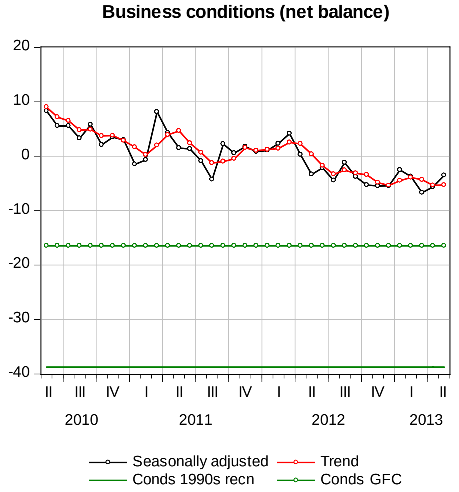
Next release:
9 July 2013 (June monthly)

Analysis

Business conditions rose for a second consecutive month, up 2 points to -4 index points in May, though the still negative reading implies that activity continued to track below trend. Business conditions picked up strongly in most of the 'weaker' industries, including wholesale, manufacturing and construction, though activity was crunched in mining, with the demand induced softness in commodity prices likely to be weighing heavily on activity. While it is possible that the lower Australian dollar has helped activity in the trade dependent industries – consistent with a pick-up in manufacturing activity in the month – the general lack of consumer confidence appears to be keeping conditions reasonably difficult in the consumer dependent sectors of the economy. Despite picking up marginally, capacity utilisation, forward orders and employment conditions remained subdued in May, providing little indication of any near-term improvement in business activity.

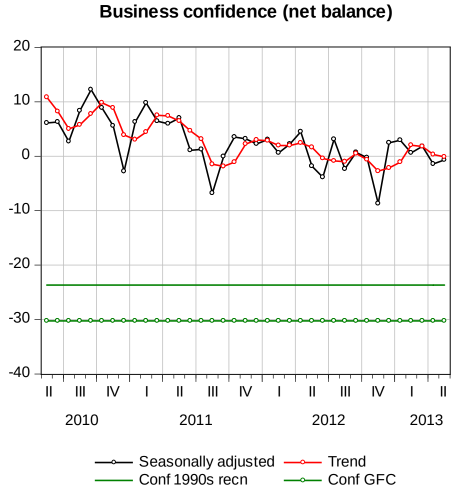
Business confidence was unchanged at a fairly meagre -1 point in May, and remained well below the series long-run average level of +5 points since 1989. While mining confidence lifted in May, mining remained by far the most pessimistic industry overall, probably reflecting concern about the impending slowdown in mining investment. Confidence generally deteriorated elsewhere. While this survey provides the first business activity reading since the RBA lowered the cash rate in May and since the Australian dollar's most recent tumble, the implied weakness in the domestic economy driving these instruments lower may have worked to offset any anticipated improvement in sentiment. Despite confidence remaining in negative territory in the month, overall confidence remains better than it was throughout much of 2012, possibly helped by lower interest rates and the somewhat better performance of equity markets.

Conditions improve a touch but still poor overall



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

Confidence still lacklustre



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 lifted solidly in wholesale (up 12 to -4 points), manufacturing (up 8 to -13 points) and construction (up 6 to -4 points) in May, though activity in these industries remained fairly subdued overall. It is possible that the recent depreciation of the Australian dollar has provided some limited relief for these industries over the past month. In contrast, conditions deteriorated significantly in mining (down 12 to -10 points), which is consistent with the general demand induced deterioration in commodity prices, especially iron ore over more recent weeks. Interestingly, retail business conditions, which were little changed in the month (down 1 to -9 index points), are much less subdued than they were just six months ago, but much of the improvement reflects a marked pick-up in employment conditions; profitability and trading conditions remained weak. Activity was relatively strong in recreation & personal services (+4), transport & utilities and finance/ business/ property (both +1), while it was very weak in manufacturing (-13), mining (-10) and retail (-9). Overall, activity in the consumer dependent sectors (with the exception of recreation & personal services) remained poor in May. Until consumer's reluctance to borrow and spend on discretionary items eases it unlikely that we will see a sustained improvement in consumption growth.

Analysis (cont.)

Business conditions by state. In May, trend conditions weakened moderately in WA and SA, where activity was weakest. The deterioration in WA conditions is consistent with the decline in mining activity while SA conditions may have faltered as a result of the vast amount of uncertainty surrounding a number of future maritime defence projects, which is already having a real impact on jobs in the region. Trend conditions improved a touch in NSW and Queensland, while activity in Victoria was unchanged. All of the mainland states reported negative trend conditions in May; conditions in SA (-12) and WA (-8) were the weakest, while activity was least subdued in Victoria (-3) and Queensland (-4).

Business confidence by industry. The pessimism that has crept into the mining sector since mid last year has become very apparent and persistent, with this industry by far the most pessimistic overall; while mining confidence rose solidly in May, this followed a heavy deterioration in the previous month and the overall reading, at -22 points, remains depressed relative to all other industries. The pessimism in mining is consistent with the slowing in mining investment activity currently underway, which appears to be occurring more rapidly than previously anticipated due to the currently soft demand environment. The only other industries to report an improvement in confidence in the month were transport & utilities and finance/ business/ property (both up 2). Confidence slipped back in all other industries, with the largest falls reported in wholesale (down 6) and retail (down 2). Excluding mining, confidence levels were fairly similar across industries, ranging from -4 for manufacturing, construction and wholesale, to +5 for transport & utilities.

Business confidence by state. Trend business confidence was little changed across the mainland states in May – it deteriorated marginally across all states except for Queensland, where it improved a touch. In level terms, trend business confidence was again very similar across the mainland states, ranging from -3 in Victoria to +2 in Queensland.

The **forward orders** index edged higher in May – up 1 to -5 index points – but remained subdued overall. The index rebounded significantly in construction (up 26 to +3 points), more than unwinding a heavy fall in the previous month. In levels terms, orders were weakest in mining (-23), retail (-14) and manufacturing (-11), while they were least subdued in construction (+3) and finance/ business/ property (+1). **Capacity utilisation** improved a touch to 79.6% in May – a level not too dissimilar to levels reported at the bottom of the GFC. The tick-up in utilised capacity was largely driven by recreation & personal services and wholesale, which was more or less offset by large declines in utilised capacity of mining and finance/ business/ property. While capacity utilisation lifted moderately in manufacturing, it remained very low overall – consistent with weak employment conditions here – highlighting the lack of demand for Australian manufacturing output. The **stocks** index – also a good indicator of current demand – lifted a touch in May – up 2 to zero points. When combined with a slight pick up in trading activity in the month, this outcome implies inventory rebuilding may have recommenced.

The **capital expenditure** index fell 5 points to -3 index points in May, the weakest outcome in four years. The weakness was driven by a very sharp decline in mining capex – down 37 to -44 points – its lowest level in the history of the survey (this question was first asked in May 2002). The deterioration in mining capex is consistent with official data and anecdotal reports that mining investment is beginning to slow. Capital expenditure also deteriorated sharply in construction and manufacturing while changes elsewhere in the month were fairly benign. The capex index was by far the lowest in mining (-44 points), followed by manufacturing (-14) and construction (-10), while it was highest in retail and recreation & personal services (both +5). Uncertainty associated with the forthcoming Federal election may be a negative for capex plans.

Analysis (cont.)

Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¼% in Q1 2013, much higher than the actual level of -0.2%. If we assume average monthly forward orders for April and May are continued into June, the survey implies 6-monthly annualised demand growth will be around 2½% in Q2 2013. That is, a little stronger than Q1 growth but still below trend.

Similarly, based on average business conditions for Q1 2013, the survey implies 6-month annualised GDP growth (excluding mining) of around 3-3¼% in Q1 2013, somewhat higher than actual growth of 2¼%. If average monthly business conditions in April and May are continued into Q2 2013, the implied growth rate would be around 2½% in Q2 2013.

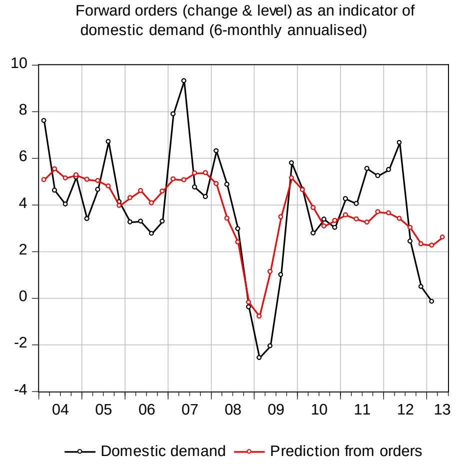
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in finance/ business/ property and wholesale, and weakest in manufacturing.

Labour costs growth (a wages bill measure) lifted to 0.9% in May, from 0.8% in April (at a quarterly rate). When combined with the slight improvement in employment conditions, this outcome suggests that wage pressures remain well contained; this is consistent with the softness implied by official data. Furthermore, the overall pace of labour costs growth remains below the series long-run average (of 1.1% since 1989). Labour costs growth was strongest in construction (1.3%, at a quarterly rate), transport & utilities and recreation & personal services (both 1.0%), while labour costs fell in mining (-0.9%), where employment conditions are very weak.

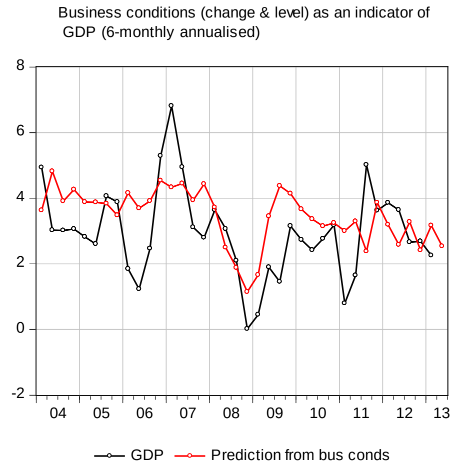
Final product prices fell marginally in May, down 0.1% following growth of 0.2% in the previous month (at a quarterly rate). Lack of price pressure is in line with poor activity indicators. Part of the fall in prices was driven by the retail sector, where prices fell by 0.2 ppts on the back of very weak trading conditions. Price pressures also softened in transport & utilities, recreation & personal services and construction compared to a month ago. In contrast, the sharp fall in wholesale prices last month was not repeated. Price deflation however continued in mining – with prices down 2.2% (quarterly rate), which is consistent with broad-based falls across the commodities complex over the month. Price inflation was barely apparent in the month, with finance/ business/ property, recreation & personal services and transport & utilities the only industries to report (slightly) higher prices.

Purchase cost growth edged up to 0.5% (at a quarterly rate) in May, almost entirely driven by stronger growth in wholesale (up 1.6 ppts to 1.6%). This was partly offset by a soft reduction in retail and recreation & personal services cost pressures. Overall, growth in purchase costs was strongest in wholesale, and softest in mining (zero growth) and manufacturing (0.1%).

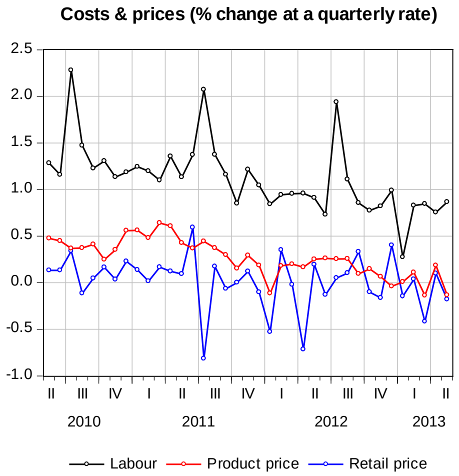
Demand growth to remain below trend in Q2



GDP (ex coal) growth to remain close to current levels in mid 2013



Prices fall despite lift in labour costs growth – margins tighten



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 a little in May – up 2 to -4 index points. However, given the weakness in previous monthly surveys, the trend business conditions index was unchanged at -5 points. That is 5 points below the series average since 1989 (a period which encompassed the early 1990s recession), implying that activity – according to the survey readings – remains sluggish with conditions generally challenging.

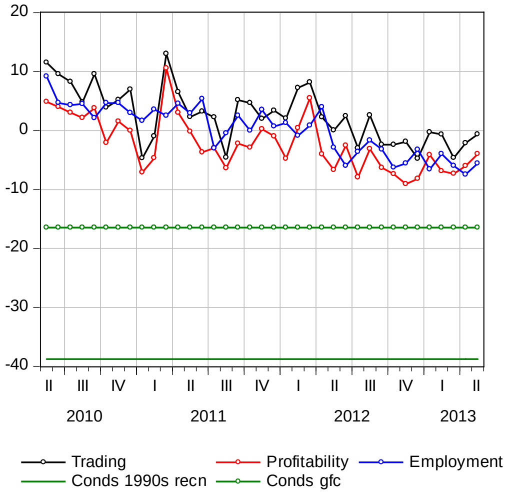
Trading, profitability and employment

The moderate rise in May business conditions reflected modest overall, improvements in profitability, trading and employment conditions in the month but with marked differences across sectors.

The improvement in **profitability** in May reflected much better profitability in wholesale (up 19) and manufacturing (up 11); while overall profitability in manufacturing was still poor, at -14, the solid pick up in the month coincided with the recent depreciation of the AUD, suggesting the international competitiveness of this industry may be improving. However, these gains were partly offset by deteriorations in recreation & personal services (down 9), mining (down 7) and retail (down 5). Profitability was weakest in manufacturing, retail (both -14) and mining (-10), while it was strongest (and positive) in transport & utilities (+9) and recreation & personal services (+5).

Broad-based improvement in profits, trading and employment

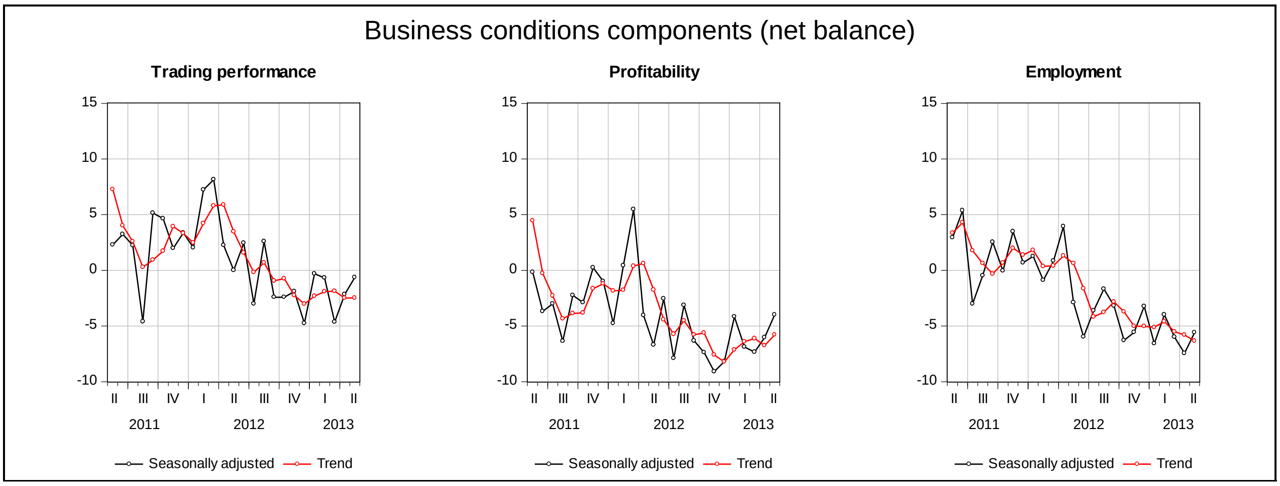
All components of business conditions (net bal., s.a.)



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

Better **trading conditions** in May largely reflected improvements in wholesale (up 12), manufacturing (up 10), finance/ business/ property (up 9) and construction (up 8), which were partly offset by deteriorations in mining and recreation & personal services (both down 11). In levels terms, trading conditions were most subdued in retail (-13) and manufacturing (-12), while they were strongest in finance/ business/ property (+8) and recreation & personal services (+7).

The slight up tick in **employment conditions** in May largely reflected solid improvements in recreation & personal services (up 10), wholesale (up 9) and manufacturing (up 6), which were partly offset by sharp falls in transport & utilities (down 16) and mining (down 13) – the only two industries to report deteriorations in employment conditions in the month. Overall employment conditions were weakest in mining (-19), construction (-12) and manufacturing (-11), while they were least subdued in retail (zero points) and recreation & personal services (-1). The generally weak employment conditions reported here are broadly consistent with other 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).

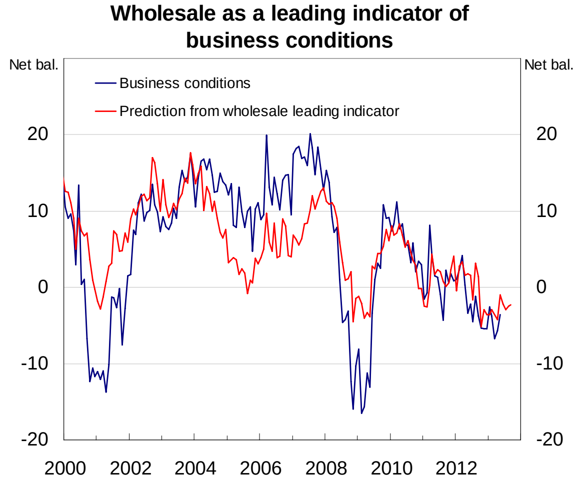
Current business conditions (cont.)

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 ticked up in May, to -12 points, and remained very poor overall.

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 trend wholesale conditions in May (-12) were to continue though to Q3 2013, overall business conditions could be expected to remain poor, averaging just -2 index points. That, in turn, is suggestive of an economy still running below trend and with little upward momentum in the growth rate.

Wholesale activity points to modestly better overall conditions



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

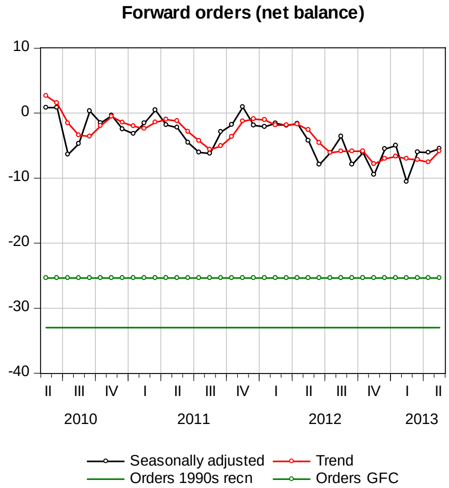
Forward orders

The forward orders index increased a touch in May, up 1 point to -5 index points, to remain modestly below the series long-run average of -1 point since 1989. The weakness encompassed in this measure of future demand implies that activity will remain poor through the middle of this year.

Forward orders rebounded in construction (up 26), more than unwinding a heavy fall in the previous month. Looking through the volatility, construction orders trended higher in May, possibly a sign that dwelling activity is picking up. In contrast, orders deteriorated heavily in transport & utilities (down 19) and retail (down 12). Orders were least subdued in construction (+3) and weakest in mining (-23).

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

New orders still weak

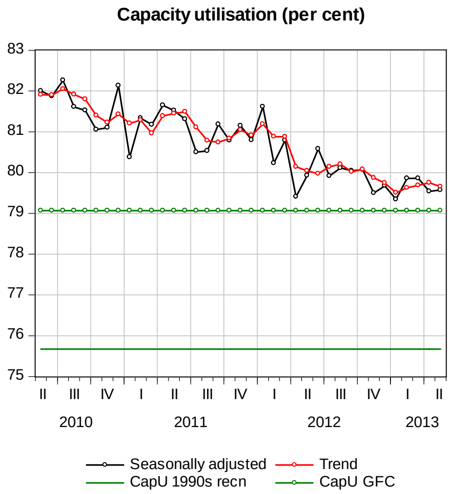


Capacity utilisation

In May, capacity utilisation rose only marginally to 79.6%, from 79.5% in April, to be a little below the series long-run average of 80.4% since 1989. Capacity utilisation increased notably in recreation & personal services (up 1.8 ppts to 81.4%) and wholesale (up 1.4 ppts). In contrast, significant falls were reported in mining (down 3.2 ppts to 79.3%) and finance/ business/ property (down 1.6 ppts). In levels terms, capacity utilisation was highest in transport & utilities (82.5%), finance/ business/ property (81.7%) and recreation & personal services (81.4%), while it was lowest in manufacturing (73.6%) and retail (78.8%).

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

Still plenty of spare capacity



Current business conditions (cont.)

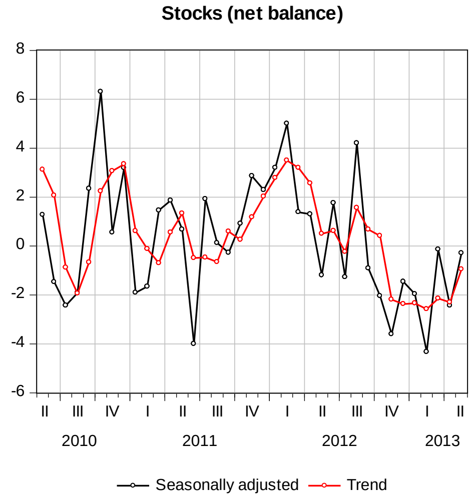
Stocks

The stocks index lifted in May – up 2 to zero index points – entirely unwinding a pull back in April. In trend terms, the index lifted marginally to -1 point, but remained below the series long-run average of +1 point since 1989.

The stocks index rose significantly in transport & utilities (up 12 to +7 points), mining and retail (both up 6), while the index fell by 2 points in construction, recreation & personal services and finance/ business/ property. Part of the implied rise in stocks may have been involuntary, particularly in the likes of retail (+9) and transport & utilities (+7) where stock levels rose to quite high levels in line with a contraction in trading activity in these industries. Mining (-13) and construction (-9) reported the lowest stock indices.

Net balance of respondents with a rise in stocks last month

Re-stocking activity resumes

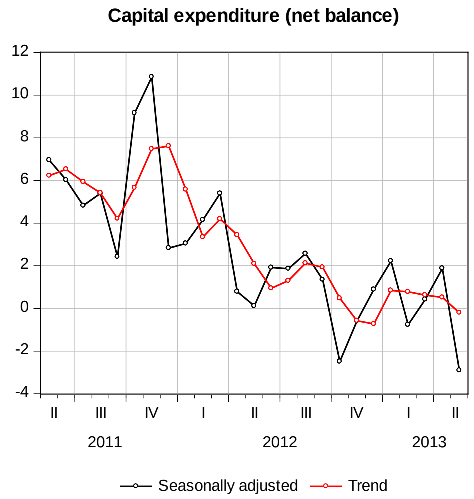


Capital expenditure

The capex index fell by a solid 5 points in May, to -3 index points. The deterioration was largely driven by an extremely large decline in mining (down 37 points to -44 points), where capex fell to its lowest level in history, as well as construction (down 13) and manufacturing (down 12). The only industries to report an improvement in capital expenditure were retail and wholesale (up 4 and 2 points respectively). In levels terms, capex was by far the lowest in mining (-44), followed by manufacturing (-14) and construction (-10), while it was highest in recreation & personal services, retail (both +5) and transport & utilities (+3).

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

Capex falls to lowest level in 4 years



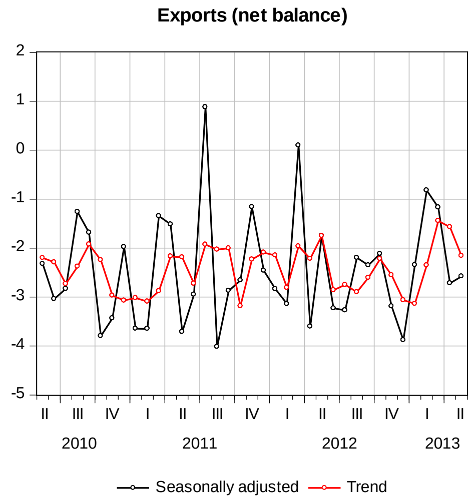
Exports

The exports index, which represents export conditions for the economy as a whole, was unchanged at -3 points in May. It appears that the recent depreciation in the AUD is yet to flow through to stronger international demand. Exports strengthened across most industries in May, with notable rises in mining (up 4) and recreation & personal services (up 3), but this was entirely offset by declines in wholesale (down 8) and finance/ business/ property (down 2). The exports index was highest in transport & utilities (+1) and lowest in manufacturing (-9) and wholesale (-5).

The exporters' sales index, which represents export conditions for exporting industries, was also unchanged at -11 points.

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

Exports unaffected by lower AUD



Current business conditions (cont.)

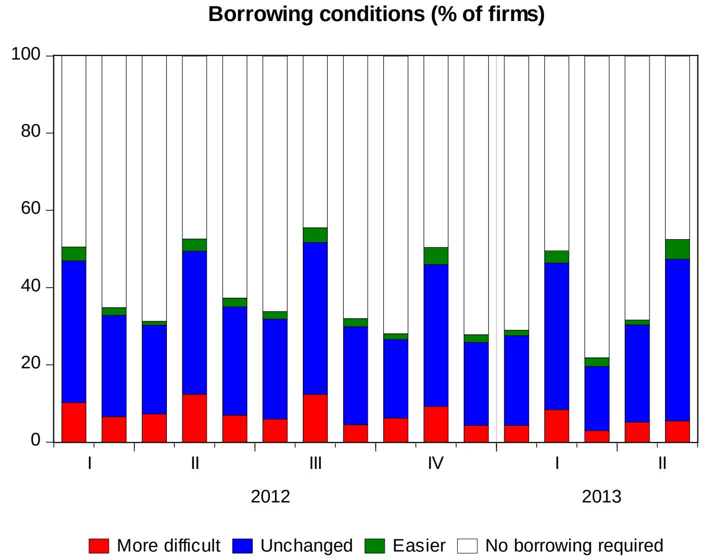
Credit availability

Borrowing conditions improved moderately in May following the RBA rate cut at the beginning of the month, suggesting that finance became easier for businesses to access in the month.

The net borrowing index (easier minus harder) rose from -4 to zero points in May – the first non-negative reading since April 2011. This outcome reflected a rise in the proportion of firms finding borrowing easier, while the proportion of firms finding borrowing more difficult to obtain was unchanged. Overall, around 52% of firms required borrowing in May.

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

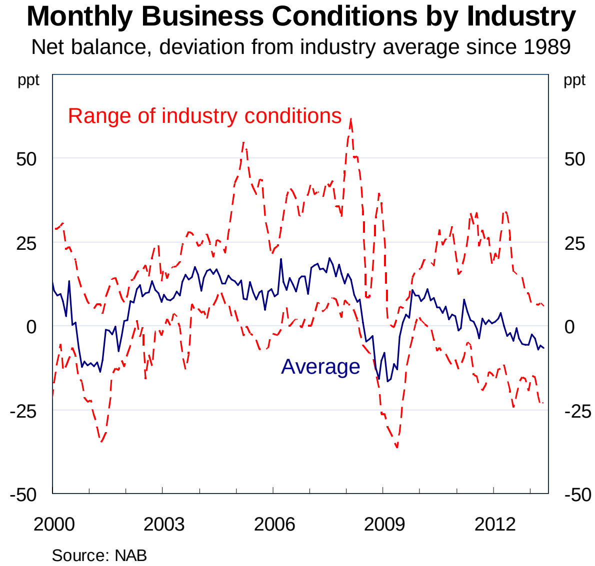
Borrowing conditions easiest in two years



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 dependent 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.

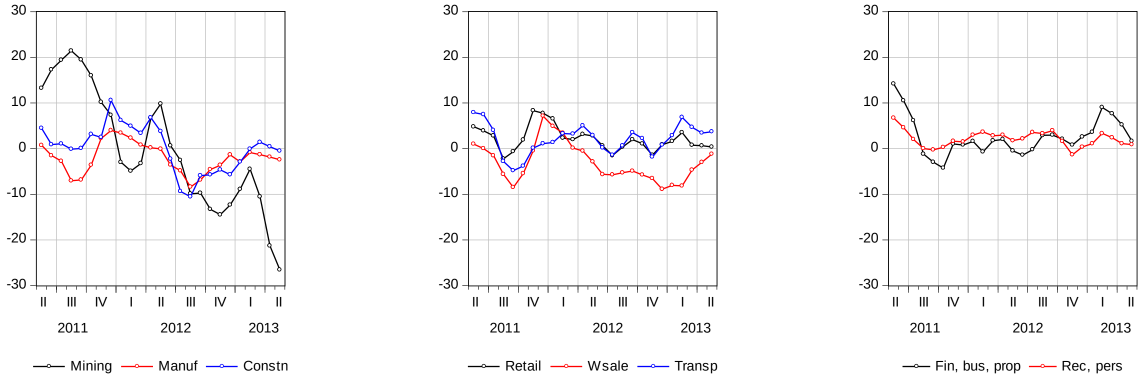
While the variation in conditions across industries has narrowed more recently, it largely reflects a weakening in conditions of the previously stronger performing industries – including mining, services and transport firms – suggesting weakness elsewhere may be spreading.

Range of industry conditions continues to narrow

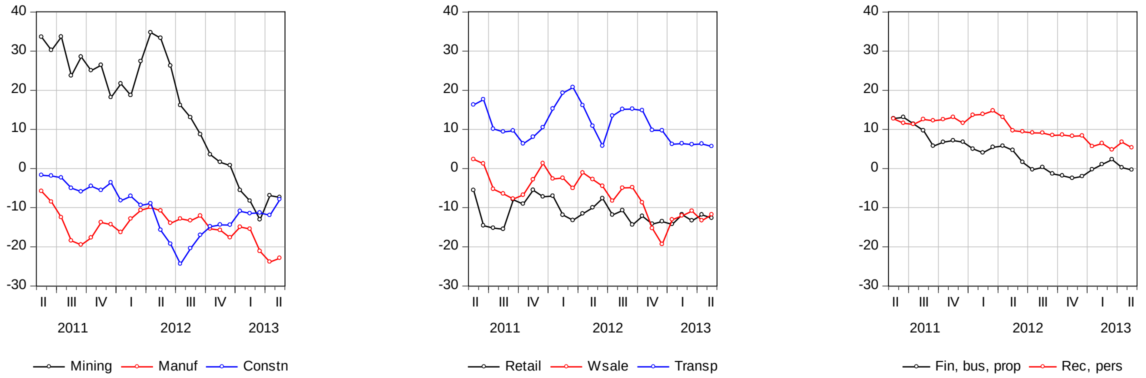


Industry sectors and states

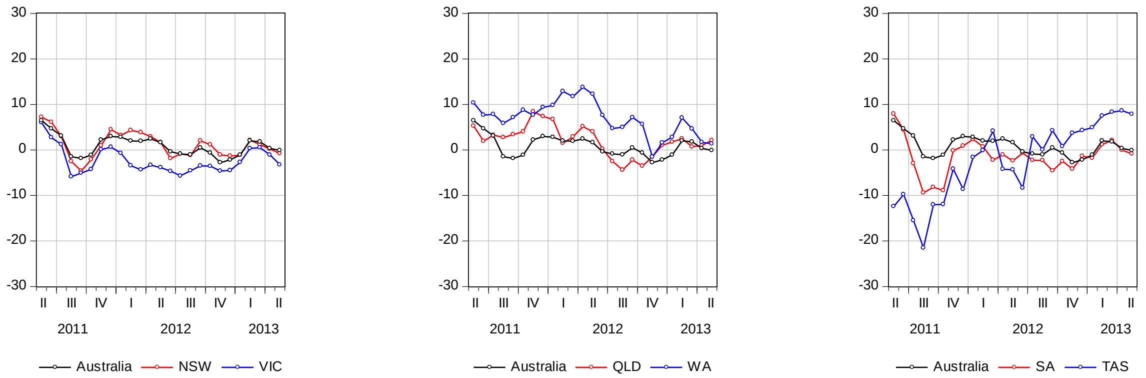
Business confidence by industry (net balance): 3-month moving average



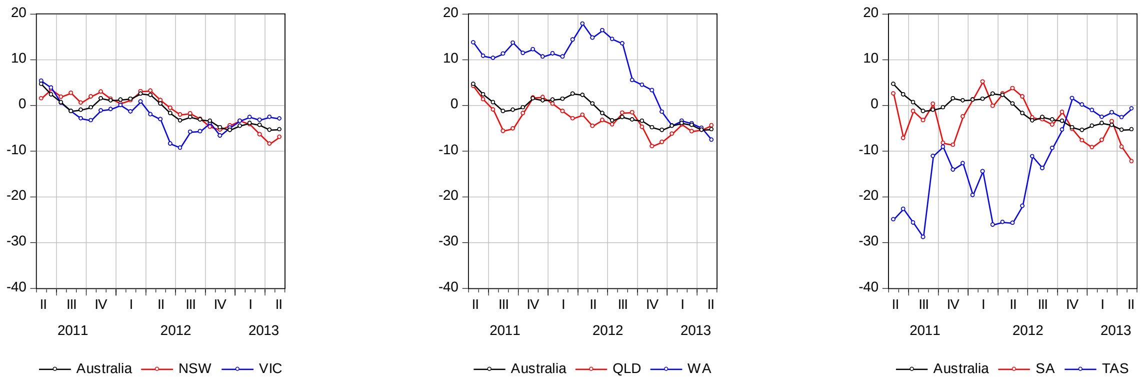
Business conditions by industry (net balance): 3-month moving average



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



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



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Melbourne	+800 842 3301	+(61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+(44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
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