National Australia Bank

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Quarterly Business Survey — June quarter 2013

Business conditions struggle in the June quarter and confidence falls back, driven by a pessimistic mining sector. Falling equities and offshore concerns likely to be weighing on sentiment. Little sign yet that lower interest rates and AUD are helping. Conditions still very subdued in trade and consumer dependent sectors. Forward indicators still worrying. Capex expectations a little stronger but mining much weaker. Falling prices imply soft Q2 inflation.

- Business confidence pared back earlier gains, with the index slipping into negative territory in the June quarter. While better than 2012, confidence remains below long-run average levels. Firms may be worried about falling equity and commodity prices, speculation about US Fed stimulus being unwound and the softening outlook for the Chinese economy. Lower borrowing rates and a falling AUD yet to show up in confidence.
- Business conditions weakened marginally in the June quarter and remain close to four year lows. The Survey points to GDP growth in the June quarter of below trend 2¾%. Already subdued forward indicators of demand generally weakened in Q2 – especially employment conditions and capacity utilisation – providing little sign that activity will improve into the second half of this year. Consistent with this, firms are having little trouble finding suitable labour in the current environment.
- Business conditions were especially weak in mining, manufacturing and retail, suggesting lower borrowing rates and a falling AUD have done little to support activity in these industries. The services sectors continue to outperform all other industries, but even these appear to have been adversely affected by weakness elsewhere. Conditions weakened across all states in the quarter with the exception of NSW. Weakness was particularly evident in WA, where the mining slowdown is gaining traction.
- Business investment intentions (next 12 months) improved a touch in the June quarter but remained low relative to outcomes a year or two ago. While investment intentions of the non-mining sector generally improved, the lift is unlikely to be sufficient to fill the ‘gap’ from the slowing in mining investment. Near and longer term employment expectations fell back, pointing to more labour market weakness. Lack of demand is expected to be the most significant factor impacting profitability over the next 12 months and concerns about tax & government policy remain important.
- Product prices fell for the first time in the history of the survey in the June quarter, recording annualised deflation of 0.2%. Price inflation was less subdued in the retail sector, recording no growth in Q2, but this outcome still points to a very soft June quarter core inflation outcome. Labour and purchase costs remained modestly below-average levels.

Implications for NAB forecasts:

- No change to latest Global and Australian Forecasts (released 9 July).

Key quarterly business statistics**

	2012q4	2013q1	**2013q2**		2012q4	2013q1	**2013q2**
		Net balance				*Net balance*	
Business confidence	-6	2	**-1**	Trading	-3	-2	**-3**
Business conditions				Profitability	-8	-6	**-5**
Current	-5	-3	**-4**	Employment	-4	-3	**-5**
Next 3 months	-2	5	**2**	Forward orders	-8	-8	**-7**
Next 12 months	11	17	**13**	Stocks	-2	-3	**0**
Capex plans (next 12)	10	13	**15**	Exports	-2	-1	**-3**
		% change				*% change*	
Labour costs	0.5	0.5	**0.5**	Retail prices	0.0	-0.1	**0.0**
Purchase costs	0.4	0.4	**0.3**			*Per cent*	
Final products prices	0.1	0.0	**0.0**	Capacity utilisation rate	79.3	80.3	**79.4**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 27 May to 13 June 2013, covering over 900 firms across the non-farm business sector.

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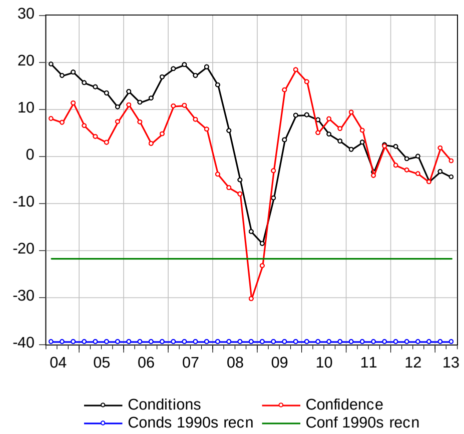
Next release:
13 August 2013 (July Monthly)

Analysis

The tone of the June quarterly business survey is fairly well explained by the relatively lacklustre level of **business confidence**; the confidence index fell by 3 points to -1 index point, partly unwinding a notable rise in the previous quarter. Despite the fall in the quarter, firms are more confident than they were throughout 2012. During the June quarter, equity prices were paring back earlier gains, speculation about the US Fed tapering stimulus plans were intensifying and softness in Chinese activity data was becoming more entrenched. These factors are likely to have weighed on sentiment of domestic firms. Furthermore, uncertainty at home in the lead up to the Federal election (which at the time the Survey was conducted was expected to take place in September) may have played a role. At -1 point, business confidence is below the long-run average of +4 points since 1989. Confidence readings in the quarterly business survey were consistent with average monthly survey readings.

Conditions turn down



Confidence = excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next 3 months to change?

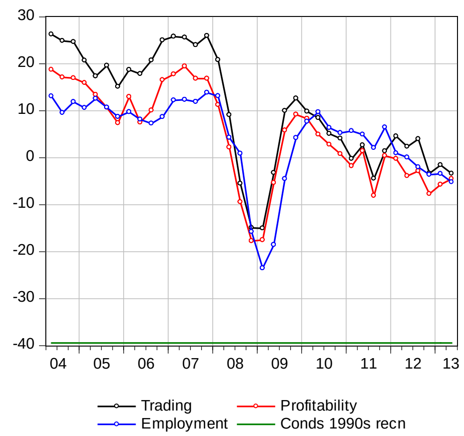
Conditions = average of the indexes of trading conditions, profitability and employment.

Business conditions edged marginally lower in the June quarter – down 1 to -4 index points – representing the third consecutive quarter of sub-zero activity readings. The quarterly business conditions index was towards the higher end of the range of monthly data.

	Quarterly					*Monthly*				
	2012q2	2012q3	2012q4	2013q1	**2013q2**	2013m02	2013m03	2013m04	2013m05	2013m06
Confidence	-3	-4	-6	2	**-1**	0	2	-1	-1	0
Conditions	-1	0	-5	-3	**-4**	-4	-7	-6	-4	-8

The slight tick down in the **business conditions** index in the June quarter reflected weaker employment and trading conditions, which were partly offset by an improvement in profitability. By industry, conditions deteriorated most notably in mining – where they were very weak – and finance/ business/ property. In contrast, activity strengthened sharply in wholesale, and improved a touch in transport & utilities and recreation & personal services, where conditions were strongest. Conditions were weakest in mining (consistent with relatively low commodity prices and the unwinding of mining investment), manufacturing and retail. The weakness in the latter two industries suggests that lower borrowing costs and a falling Australian dollar have done little to boost activity in the quarter.

Activity measures mixed; still relatively subdued

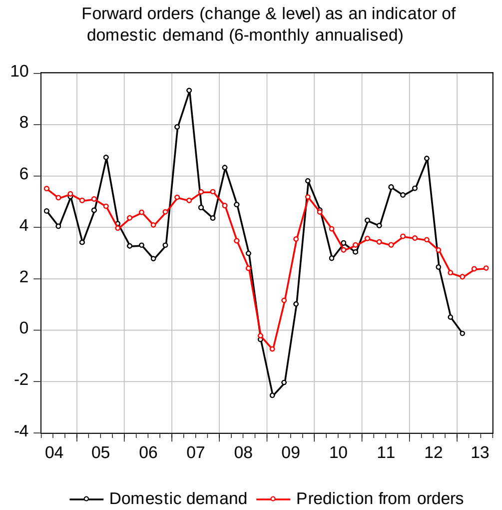


Net balance of respondents who regard last 3 months' trading / profitability / employment performance as good.

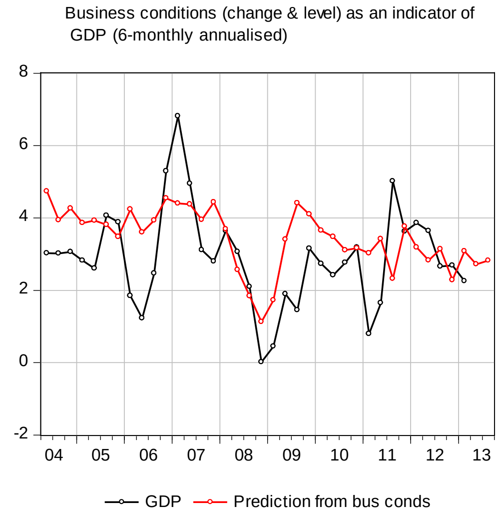
	Quarterly					*Monthly*				
	2012q2	2012q3	2012q4	2013q1	**2013q2**	2013m02	2013m03	2013m04	2013m05	2013m06
Trading	2	4	-3	-2	**-3**	-1	-5	-3	-1	-7
Profitability	-4	-3	-8	-6	**-5**	-7	-9	-7	-5	-8
Employment	0	-2	-4	-3	**-5**	-4	-6	-8	-6	-6

Analysis (cont.)

Demand growth to remain soft

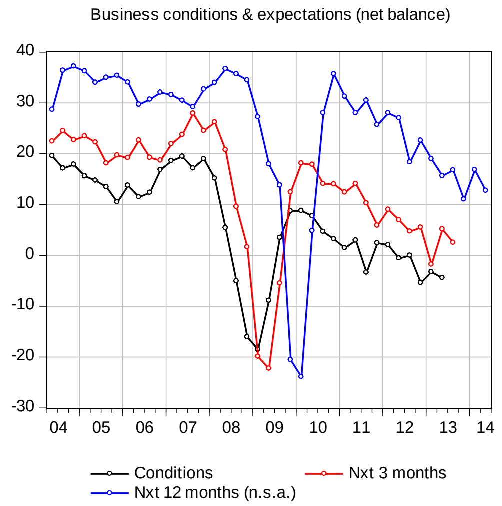


GDP growth to remain modest

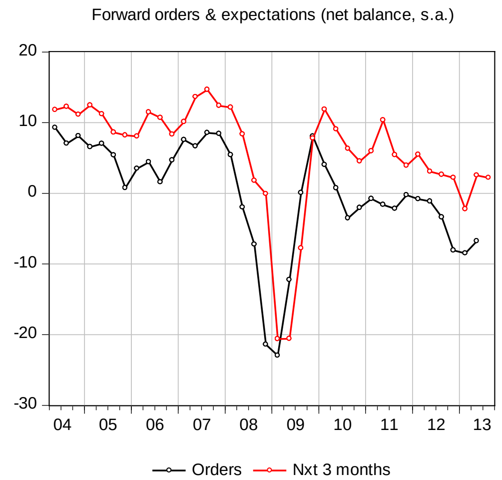


Based on forward orders in the June quarter, the survey implies that 6-monthly annualised demand growth was a fairly modest 2¼-2½% in the June quarter. If we assume forward orders for the June quarter are continued into the September quarter, the survey implies 6-monthly annualised demand growth will remain close to this level. Similarly, based on business conditions in the June quarter, the survey implies that 6-monthly annualised GDP growth was a below-trend 2¾% in the June quarter. If June quarter business conditions are maintained into the September quarter, the implied growth rate would remain close to this level.

Expectations trending lower



Orders still very weak



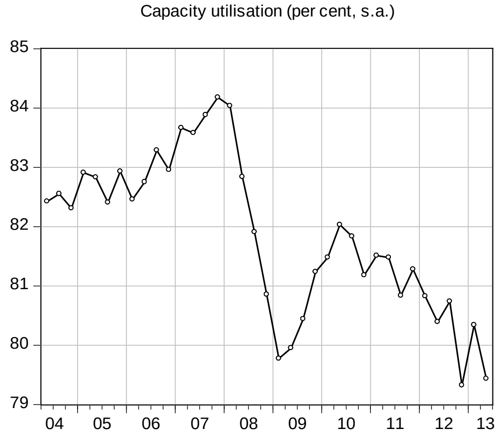
Consistent with actual conditions, short and long-term expectations for business conditions fell back in the June quarter, and they remain weak relative to expectations over the post-GFC period. While marginally higher in the quarter, at -7 index points, the forward orders index remained very subdued implying little improvement in near-term demand. Near-term expectations for orders were marginally softer than in the previous quarter, pointing to little strengthening in activity over the remainder of this year.

	Quarterly [(a)]					*Monthly*				
	2013q1	2013q2	2013q3	2014q1	2014q2	2013m02	2013m03	2013m04	2013m05	2013m06
Conditions	-3	**-4**				-4	-7	-6	-4	-8
Conds. next 3m	-2	5	**2**							
Conds. nxt 12m	19	16	17	17	**13**					
Orders	-8	**-7**				-11	-6	-6	-6	-5
Orders next 3m	-2	3	**2**							

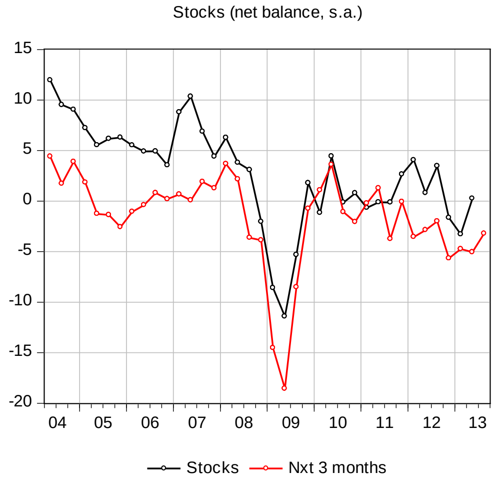
(a) Quarter to which expectation applies. Business conditions next 12 months not seasonally adjusted.

Analysis (cont.)

Plenty of spare capacity



Broad-based rise in stocks, consistent with weaker trading



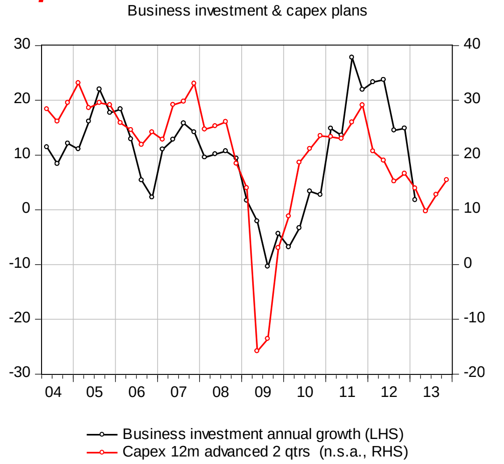
Capacity utilisation fell back considerably in the June quarter, almost entirely offsetting a solid rise in the March quarter. The current rate, at 79.4%, is 1.2 ppts below the series long-run average, and 0.4 ppts below post-GFC lows. The level of excess capacity implied by this survey suggests that, with the exception of general maintenance and repairs, firms are under no pressure to undertake new investment. The stocks index rose modestly in the quarter, but at zero index points, the outcome suggests that inventory accumulation was only just sufficient to offset the reduction in stock due to sales. Expectations for stocks (over the next three months) were a little better, suggesting firms may commence re-stocking in the next quarter.

	Quarterly [(a)]					*Monthly*				
	2012q3	2012q4	2013q1	2013q2	2013q3	2013m02	2013m03	2013m04	2013m05	2013m06
Capacity utilis.	80.7	79.3	80.3	**79.4**		79.9	79.9	79.5	79.5	79.3
Stocks current	3	-2	-3	**0**		-5	0	-3	-1	-5
Stocks next 3m	-2	-6	-5	-5	**-3**					

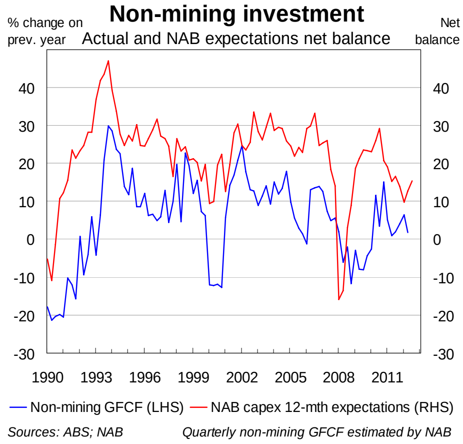
(a) Quarter to which expectation applies. All data are seasonally adjusted.

Analysis (cont.)

Capex intentions still subdued…

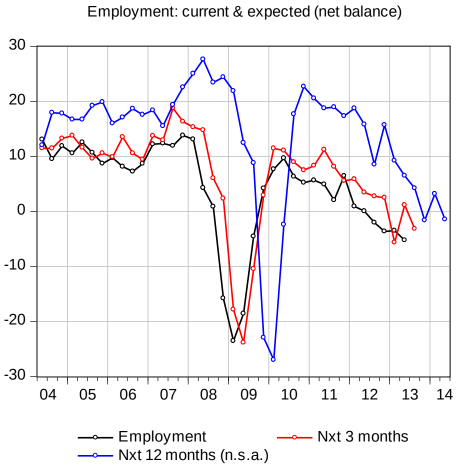


…especially in mining

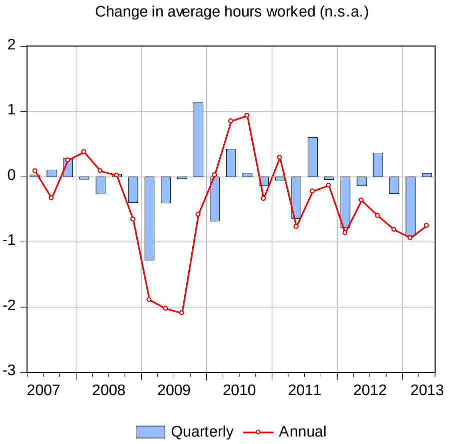


The NAB survey measure of business capital expenditure suggests business investment growth may lift marginally in the next six to 12 months. However, caution should be exercised when interpreting capex data as mining respondents are under represented in our survey, meaning the degree of slowing in mining investment is unlikely to be fully captured. Indeed, expectations for mining capital expenditure fell notably to -3 points in the June quarter. The expectation for mining investment to fall is consistent with the story that the Australian mining boom is transitioning from the investment phase into the production and exports phase, as mining projects approach completion. Furthermore, declines in commodity prices have brought into question the viability of a number of prospective mining projects, suggesting the slowing may occur more abruptly than previously anticipated. Capex intentions across the non-resources sector generally improved in the quarter. However, any pick-up in non-mining investment is unlikely to be sufficient to fully offset the rapid slowing in mining investment.

Near-term employment expectations deteriorate



Average hours little changed at low level

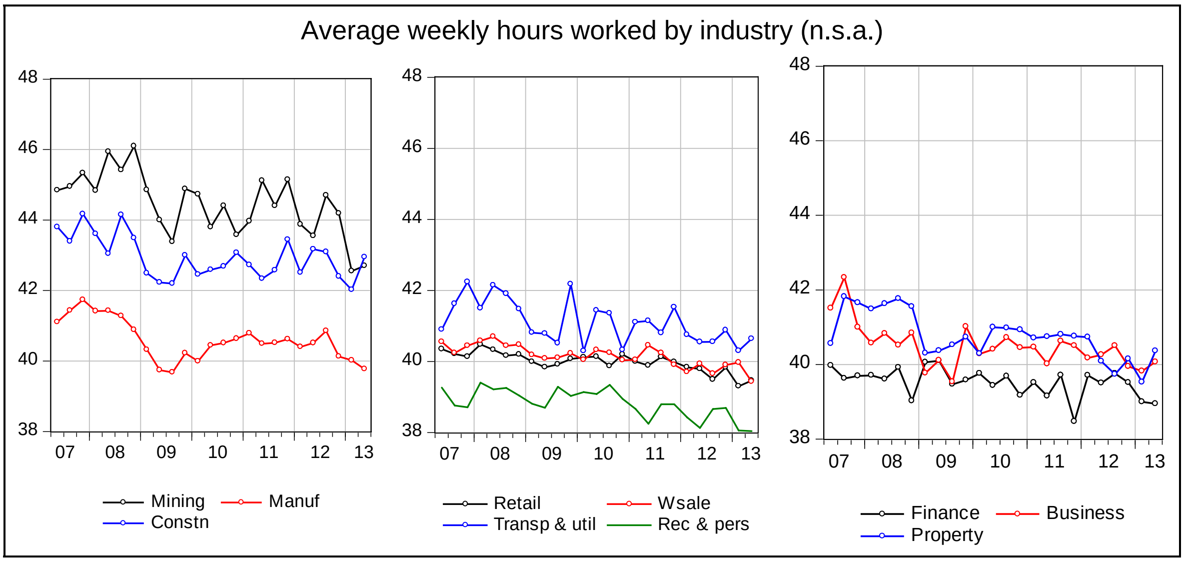


The employment index fell to a four year low in the June quarter, and at -5 points, remained below the long-run average of zero points since 1989. Employment expectations were also subdued relative to average expectations throughout the post-GFC period, which is consistent with other market measures of labour market conditions (including job ads and vacancies data).

Average weekly hours worked were broadly unchanged, at 39.7 hours in the June quarter, after falling notably in the previous quarter. While average hours remained broadly unchanged, a contraction in employment conditions suggests employers are having to reduce heads in the current weak activity environment. By industry, average hours worked was again highest in construction and mining, while they were lowest in recreation & personal services, likely reflecting a greater reliance on casual and part-time workers in this sector.

Analysis (cont.)

Average hours highest in mining and construction; much lower in recreation & personal services, probably reflecting part-timers



	Quarterly[a]					Monthly				
	2013q1	2013q2	2013q3	2014q1	2014q2	2013m02	2013m03	2013m04	2013m05	2013m06
Empl current	-3	**-5**				-4	-6	-8	-6	-6
Empl next 3m	-6	1	**-3**							
Empl nxt 12m	9	6	4	3	**-1**					

(a) Quarter to which expectation applies. Employment conditions next 12 months not seasonally adjusted.

Output much less constrained by labour availability relative to a year ago

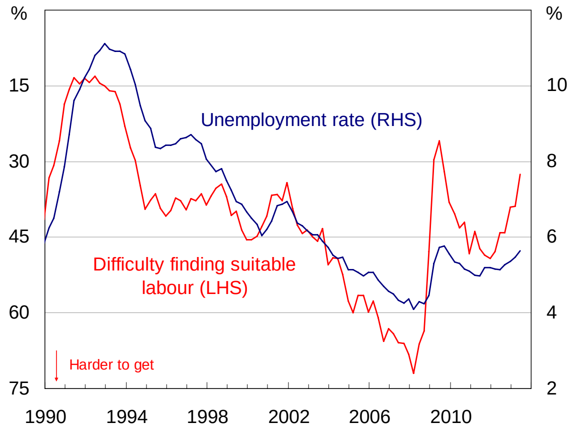
Sales remained the most constraining factor on output in the June quarter, with close to 60% of firms reporting lack of sales and orders as their number one constraint. This outcome is consistent with the weakness in trading conditions and forward orders in the quarter. While still significant, labour is becoming increasingly less of a constraint on firms' output, which is in line with a rising national unemployment rate (ABS data show that the unemployment rate rose to 5.7% in June quarter 2013, up from 5.2% one year earlier). Premises & plant and materials became slightly less constraining in the June quarter and were viewed as fairly minor constraints on output overall. These factors also remain significantly less constraining than they were in the lead up to the GFC, when capacity utilisation was fairly tight (especially compared to the current level).

Analysis (cont.)

The Survey measure of labour as a constraint on output (reversed) has historically moved quite closely with the unemployment rate. Just prior to the GFC in late 2008, over 70 per cent of firms reported that labour was a significant factor constraining output. The unemployment rate rose rapidly following the GFC, and consistent with this, firms were reporting significantly less difficulty finding access to suitable labour (less than 30 per cent of firms reported it as a constraint on output at the end of 2009). After the unemployment rate peaked in late 2009, it became increasingly difficult for firms to obtain suitable labour in the face of improving labour market conditions and the recommencement of hiring. More recently, the unemployment has started to trend higher, as has the ease of finding suitable labour, suggesting labour market conditions are becoming less constraining.

Labour relatively easy to find; consistent with rising unemployment

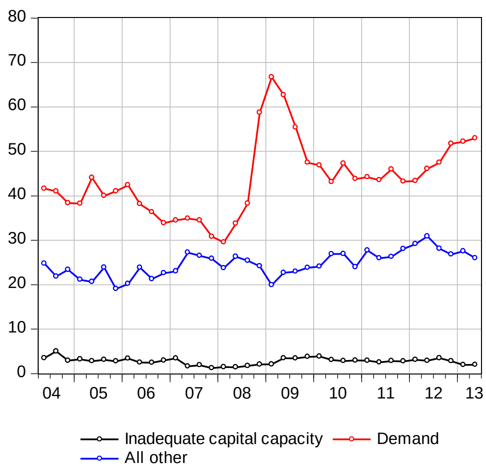
Unemployment rate & labour constraints



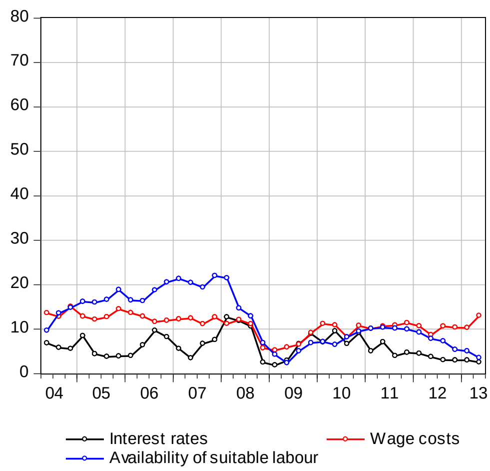
Sources: ABS; NAB

Demand expected to constrain profitability over 2013

Main constraint on profitability (% of firms)



Main constraint on profitability (% of firms)



Lack of demand is expected to be the most constraining factor on firms' profitability over the next 12 months, with more than half of respondents reporting demand as a major constraint on future profitability. Firms also reported 'all other' factors as relatively constraining in the June quarter; around half of this category represented concern about the impact of tax & government policy on future profitability, although a slightly smaller proportion of firms reported this as a major constraint compared to in the previous quarter. Consistent with historically low borrowing rates as well as the relatively low rate of capacity utilisation in the economy at present, respondents view interest rates, inadequate capital capacity and the availability of suitable labour as relatively minor constraints on future profitability. The proportion of firms reporting wage costs as constraining factors rose sharply but was still relatively low at around 13%.

Constraints on output (% of firms)*	2012q2	2013q1	2013q2
Sales & orders	60.3	60.0	**57.9**
Labour	39.0	38.9	**32.5**
Premises & plant	19.1	22.2	**18.4**
Materials	9.6	11.4	**8.6**

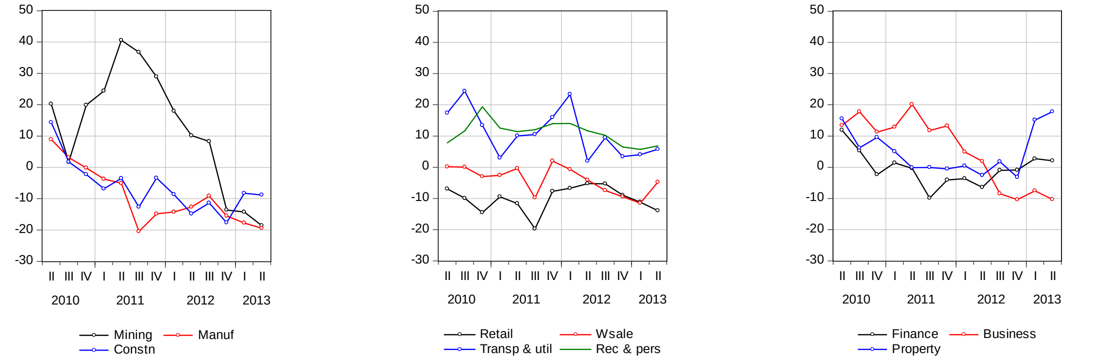
Main constraints on profitability (% of firms)*	2012q2	2013q1	2013q2
Interest rates	3.0	3.0	**2.5**
Wage costs	10.4	10.3	**13.0**
Labour	5.3	5.0	**3.5**
Capital	2.8	1.9	**2.0**
Demand	51.7	52.2	**53.0**
All other	26.8	27.5	**26.0**

** not s.a.*

Industry and state analysis

Business conditions: manufacturing, mining & retail still very weak

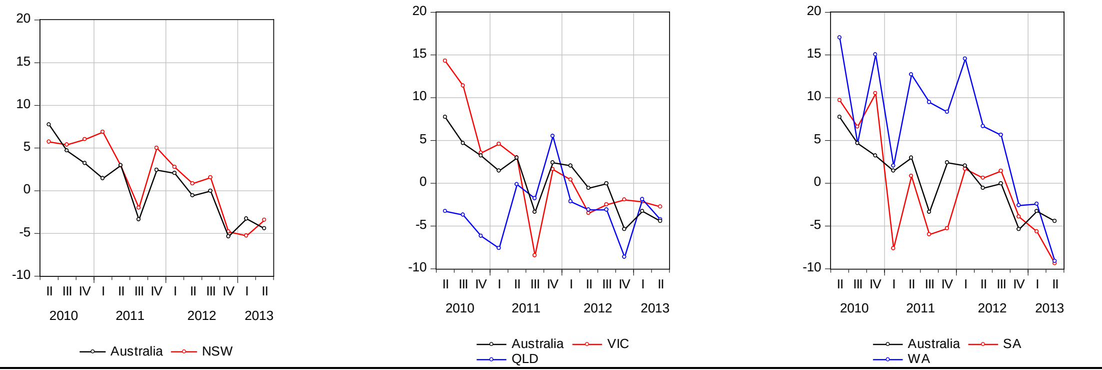
Business conditions (s.a., net balance)



Business conditions were mixed across industries in the June quarter. Conditions deteriorated notably in mining and finance/ business/ property (both down 5), while they were a touch weaker in retail (down 3), construction and manufacturing (both down 1). In contrast, conditions strengthened in wholesale (up 7), transport & utilities (up 2) and recreation & personal services (up 1). There were some marked variations in conditions within the finance/ business/ property sector; property services performed strongly, with conditions lifting to a three and a half year high, while business services conditions were at the other end of the spectrum. Financial services conditions have trended higher over the past two years, but remain reasonably soft. Mining and manufacturing (both -19 points) had the weakest conditions of all industries; for mining, this is consistent with lower commodity prices, while it appears that manufacturing is yet to benefit from the lower Australian dollar. Conditions were also weak in retail (-14), which is consistent with weakness in official sales data, while conditions were relatively strong in recreation & personal services (+7) and transport & utilities (+6).

Business conditions: Very weak in WA & SA, esp. compared to a year ago

Business conditions (s.a., net balance)

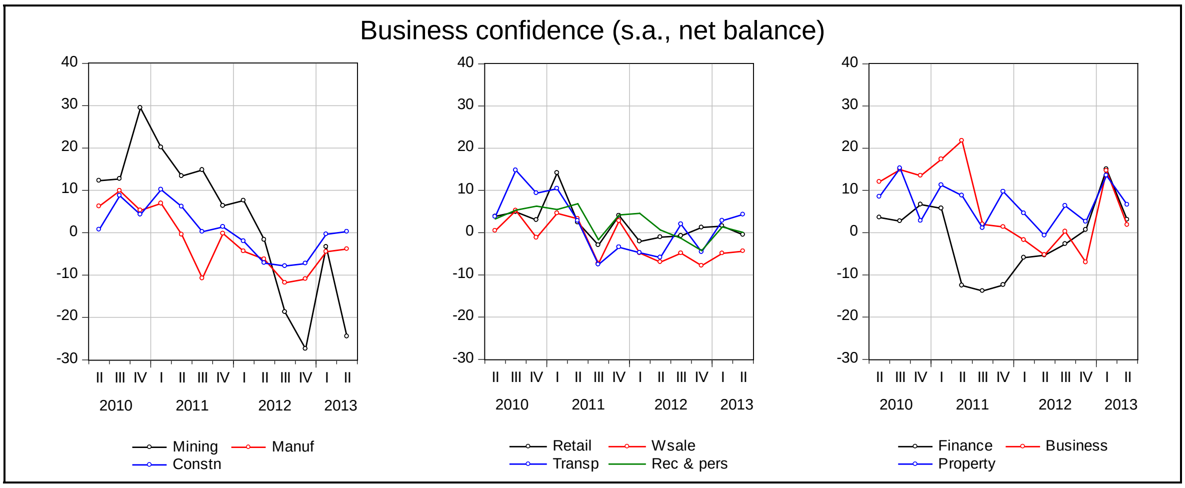


Business conditions deteriorated across all mainland states in the quarter, with the exception of NSW, where they were modestly better (up 2). The largest deterioration was reported in WA (down 7), in accordance with a notable weakening in mining conditions. Conditions also fell in SA (down 3), which could partly reflect public sector cut backs. Tasmanian conditions declined heavily (down 6 to -9 points), with this state struggling with soft tourism activity and public sector fiscal restraint. WA and SA were the weakest performing mainland states (both -9), while conditions were least subdued (albeit still poor) in NSW, Victoria (both -3) and Queensland (-4).

	Quarterly					*Monthly*				
	2012q2	2012q3	2012q4	2013q1	2013q2	2013m02	2013m03	2013m04	2013m05	2013m06
Business conditions										
NSW	1	2	-5	-5	**-3**	-7	-8	-12	-3	-5
VIC	-4	-3	-2	-2	**-3**	-1	-6	0	-3	-10
QLD	-3	-3	-9	-2	**-4**	-6	-5	-6	-5	-9
SA	1	1	-4	-6	**-9**	-4	-4	-20	-13	-3
WA	7	6	-3	-2	**-9**	1	-13	-4	-7	-10

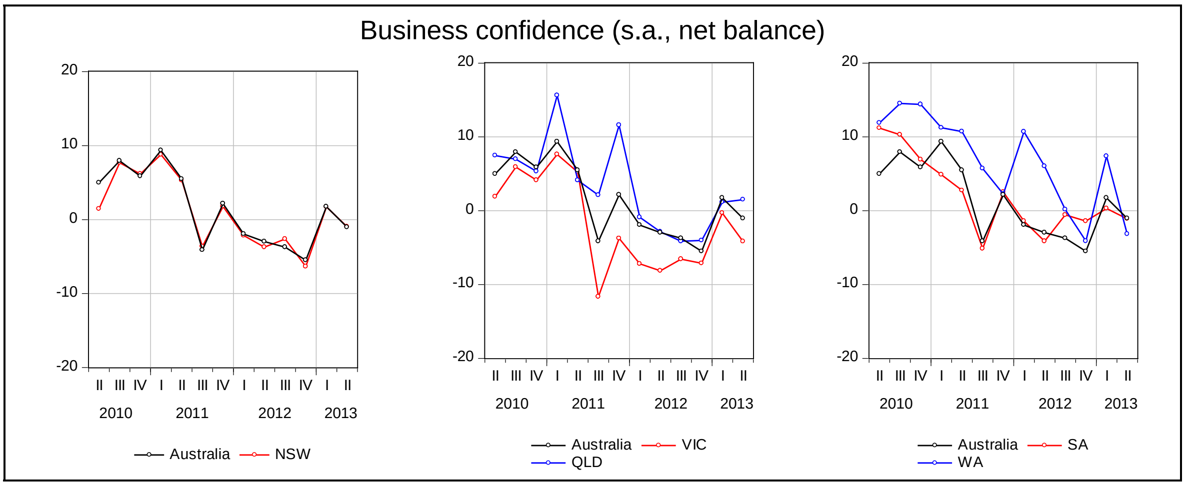
Industry and state analysis (cont.)

Business confidence: mining very pessimistic, other industries less so



Business confidence fell heavily in mining in the June quarter (down 21) almost entirely unwinding a sharp pick-up in the previous quarter. At -24 points, the mining sector is by far the least confident industry, with a falling terms of trade and softening outlook for the Chinese economy likely to be weighing heavily on sentiment. Elsewhere, confidence fell back in finance/ business/ property (down 11), while it lifted marginally in manufacturing, construction, wholesale and transport & utilities (all up 1). With the exception of mining, confidence levels across industries were broadly similar, ranging from -4 points for manufacturing, to +4 points for transport & utilities.

Business confidence: confidence deteriorates in all states but QLD



Business confidence weakened across all mainland states, with the exception of Queensland, where it was unchanged. At +1 point, Queensland was the only state with a positive confidence reading in the June quarter. Consistent with a sharp deterioration in business conditions, confidence fell significantly in WA (down 10 to -3 points), while it was modestly lower in Victoria (down 4) and NSW (down 3). Confidence also softened in Tasmania, falling from +2 points in the March quarter, to zero points. In levels terms, confidence in the mainland states was weakest in Victoria (-4) and WA (-3), and least subdued in Queensland (+1), NSW and SA (both -1).

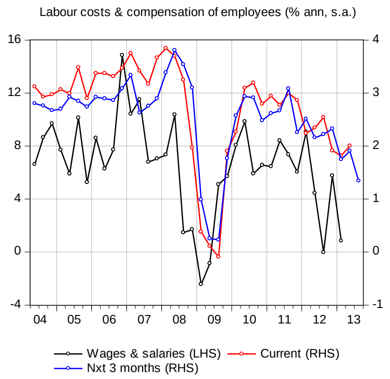
	Quarterly					*Monthly*				
	2012q2	2012q3	2012q4	2013q1	2013q2	2013m02	2013m03	2013m04	2013m05	2013m06
Business confidence										
NSW	-4	-3	-6	2	**-1**	1	-1	-1	-2	-1
VIC	-8	-7	-7	0	**-4**	1	-1	-3	-6	-4
QLD	-3	-4	-4	1	**1**	-1	2	2	3	1
SA	-4	-1	-1	0	**-1**	1	3	-4	-1	3
WA	6	0	-4	7	**-3**	0	5	-1	0	-3

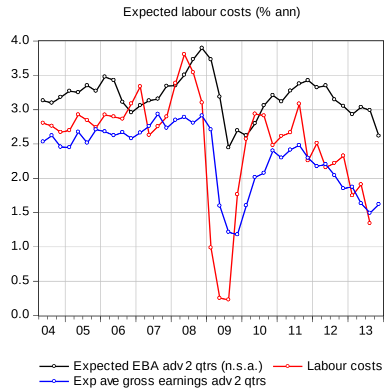
Inflation and costs

Prices fall for most industries; retail prices point to soft Q2 core inflation

Consistent with the softness in domestic demand, product price pressures were very subdued in the June quarter. In aggregate, prices fell marginally – representing the first quarterly decline in product prices in the history of the quarterly business survey (since 1989). This outcome reflected weaker price pressures in mining (quarterly price growth was 0.4 ppts lower in the quarter), manufacturing (0.3 ppts lower) and to a lesser extent construction, wholesale, transport & utilities and finance/ business/ property (all down 0.1 ppts). The only industry to report stronger price growth was retail, where prices were unchanged in the quarter, after falling by 0.1% in the March quarter. Deflation was most apparent in mining (-0.9%, quarterly rate), which is consistent with falling commodity prices through the quarter, followed by manufacturing, construction (both -0.3%) and wholesale (-0.1%), while price inflation was least subdued in transport & utilities and recreation & personal services (both +0.2%). The lack of inflationary pressures indicated by the survey point to a softening in underlying CPI in the June quarter.

Labour cost pressures remain subdued





Quarterly annualised **labour costs** growth picked up modestly to 2.0% in the quarter, from 1.8% previously. While the pace of annualised growth increased in the quarter, at 2.0%, it remains well below the series average of 3.0%. The relative softness in growth is in line with weak employment conditions and limited capacity pressures, which are likely to be keeping wages growth well contained. Wage increases under EBAs are expected to average 2.6% over the next year – down from 3.0% in the previous quarter – or 1.6% after allowing for productivity offsets.

On average, businesses expect short-term interest rates to fall by a further 16 bps (down from 7 bps in the March quarter). Given that the RBA has lowered the cash rate by a further 25 bps since the March quarter survey was conducted, the expectation for further cash rate cuts suggested businesses view the Australian economy less favourably than they did three months prior to the June quarter survey. Exchange rate expectations (6-months-ahead) fell to US$0.92 in the June quarter, from US$1.02 in the March quarter.

Medium-term inflation expectations remained soft, with 57% of respondents expecting inflation to remain below 3% (up from 52% in the previous quarter) and 36% expecting inflation of 3-4% (was 41%). Only 3% of respondents believe inflation is a serious problem (unchanged from previous quarter), while 25% believe it is a minor problem (29% in previously).

House prices are expected to rise by 1.4% over the next 12 months, down from 1.7% in the previous survey.

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