National Australia Bank

Embargoed until:
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Monthly Business Survey

August 2013

Confidence rises everywhere and surges in mining, construction and finance/ business/ property. This appears to reflect expectations of political change & more certainty about future political frameworks. Against that, business conditions and capacity utilisation remained poor. Retail conditions approaching GFC lows. Labour market down markedly & forward indicators still weak, with business struggling to pass on higher import costs from a lower AUD. Global & local economic and financial forecasts broadly unchanged.

- Business confidence strengthened considerably in August, with the index rising to its highest level since May 2011. The cash rate cut in August and a lower AUD may have helped sentiment but it appears more important were political factors – including an expectation of political change and more certainty about the future policy framework (this survey was conducted prior to the Federal election on 7 September). Confidence lifted in all industries and states in August. That said confidence is now only back to average levels and much will depend on whether the current bounce is maintained or erodes away in the face of poor business conditions.
- Business conditions edged marginally higher in August but fundamentally were "unchanged at soggy levels". Weakness was very apparent in retail trend conditions, which recorded the weakest reading in almost five years. Conditions were also especially weak in mining, manufacturing, construction and wholesale, while recreation & personal services was the only sector to report positive conditions. Forward indicators edged up a touch but remain at subdued levels. Particularly concerning was a slump in employment conditions (weakest since May 2009), painting a worrying outlook for the labour market. Capacity utilisation remained subdued.
- The survey implies underlying demand growth and GDP (6-monthly annualised) of around 2½-2¾% in the September quarter. Our wholesale leading indicator implies no improvement in near-term activity.
- Labour costs growth softened in August, after surging higher in July following the implementation of a higher national minimum wage. Prices rose only marginally in August (as did retail prices); when combined with moderate growth in purchase costs, it appears that margins are being further compressed.

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

- Recent business surveys show a solid and synchronised lift in business confidence across the advanced economies whose annualised quarterly industrial growth now exceeds that of the emerging economies. Big emerging market economies have been hit by financial market volatility as money moves back to the US. Growth expectations revised down for India, emerging Asia and Brazil as their monetary policy will have to be tighter than if there had been a more gradual market adjustment to the Fed's planned moves.
- June quarter national accounts confirm that the Australian economy grew below trend in the first half of this year. GDP forecasts broadly unchanged this month: GDP growth to soften to 2.3% in 2013 before gradually rising to 2.5% in 2014 and 2.9% in 2015. Unemployment to exceed 6% by end 2013 and reach 6¾% by end 2014. Consistent with soft activity outlook, core CPI expected to edge down to 2.3% by end 2013, lifting modestly to 2.6% by end 2014; rising unemployment to keep the brakes on inflation in 2015. We think there is a need for another 25 bp rate cut (probably Nov) to help industries squeezed by the mining investment slowdown.

Key monthly business statistics*

	Jun 2013	Jul 2013	**Aug 2013**		Jun 2013	Jul 2013	**Aug 2013**
	Net balance				*Net balance*		
Business confidence	-1	-3	**6**	Employment	-7	-5	**-9**
Business conditions	-8	-7	**-6**	Forward orders	-5	-6	**-4**
Trading	-7	-5	**-5**	Stocks	-5	-6	**-2**
Profitability	-9	-11	**-9**	Exports	-1	-2	**0**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.6	1.5	**0.5**	Retail prices	0.3	0.2	**0.1**
Purchase costs	0.4	1.2	**0.8**		*Per cent*		
Final products prices	-0.1	-0.1	**0.1**	Capacity utilisation rate	79.3	79.9	**80.0**

* All data seasonally adjusted and subject to revision. Cost and prices data are monthly percentage changes expressed at a quarterly rate. Fieldwork for this survey was conducted from 20 August to 3 September, covering over 600 firms across the non-farm business sector.

For more information contact:
Alan Oster, Chief Economist
(03) 8634 2927 Mobile 0414 444 652

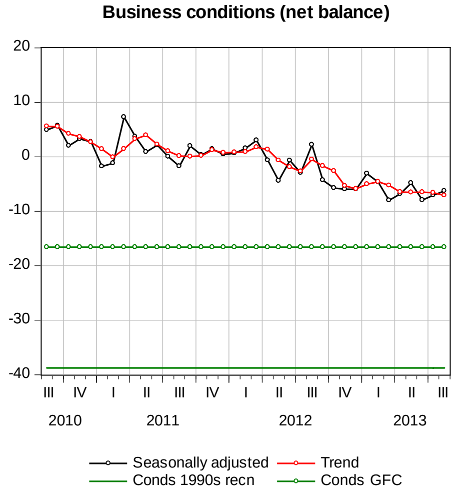
Next release:
8 October 2013 (September monthly)

Analysis

The August survey highlights the weakness in business activity which has persisted for the past 12 months, despite the low interest rate environment and, more recently, the weaker AUD. While marginally better, **business conditions** remained subdued in August, lifting 1 point to -6 index points. In the month, conditions strengthened in manufacturing, with the lower Australian dollar providing a boost to exports. Conditions were also modestly better in recreation & personal services, while they weakened considerably in mining, despite better commodity prices and stabilising Chinese growth. Furthermore, notable falls in retail, wholesale and transport & utilities conditions are likely to reflect continued cautious consumer behaviour. While up a touch in the month, forward indicators suggest little upturn in near-term activity, with forward orders and capacity utilisation remaining below long-run average levels; a slump in employment conditions to the (equal) lowest outcome in over four years paints a worrying outlook for labour market conditions.

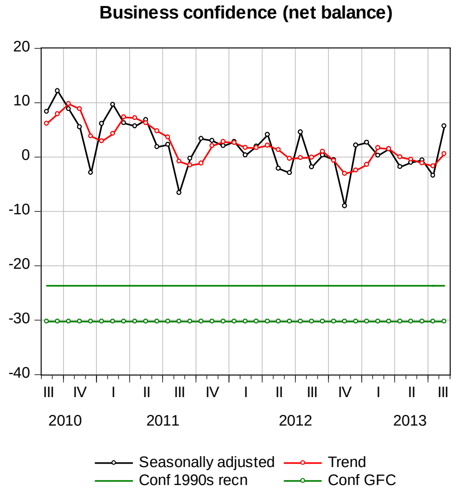
Despite subdued activity readings, businesses became much more optimistic in August. **Business confidence** improved markedly, increasing from -3 points in July to +6 points in August, which is the highest level since May 2011. While it is difficult to prove, it is likely that expectations of political change and a decisive result were very important (the survey was conducted prior to the Federal election on 7 September). The August rate cut and lower AUD while helpful are, realistically, unlikely to explain the size (sixth largest jump in the Survey's monthly history from March 1997) and breadth of the August confidence reading. All industries became more confident in the month, with particularly solid improvements in mining, construction and finance/ business/ property; the latter two industries may also be anticipating a revival in activity on the back of a strengthening property market.

Conditions remain lacklustre



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

Confidence posts a remarkable turnaround



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

Business conditions by industry. Conditions in mining deteriorated heavily in August (down 12 to -27 points), despite a general improvement in commodity prices; this may reflect a sharp deterioration in capital expenditure, which is having a severe impact on employment conditions. Conditions also weakened considerably in transport & utilities, wholesale and to a lesser extent retail. That said, retail conditions are now approaching GFC lows and are consistent with flat ABS retail trade data. In contrast, conditions strengthened notably in manufacturing (up 7 to -17 points), likely reflecting increased competitiveness in this industry as a result of the lower AUD, albeit conditions here remain difficult. Recreation & personal services remained by far the best performing industry (+13). It appears that the weaker AUD is helping to encourage more travel within Australia (both domestic and from abroad), which may be supporting better activity in service sectors. Overall, conditions were extremely weak in mining (-27), manufacturing (-17), retail (-16), construction, wholesale (both -15) and transport & utilities (-11).

Analysis (cont.)

Business conditions by state. Business conditions were weak across all states in August, despite the smaller states reporting a marginal improvement. WA and SA improved most in the month, though their conditions remained among the poorest overall, probably reflecting the direct and indirect impact of the mining investment slowdown. Victoria was the only state to report a deterioration in activity in August (down 5), but is still (at -2 points) the best performing state (both in trend and in seasonally adjusted terms). That could in part reflect the more diversified industry structure of this state. In contrast, conditions were weakest in WA (-9), SA, NSW (both -8) and Queensland (-7).

Business confidence by industry. Confidence strengthened across all industries in August. Mining firms became much less pessimistic in the month, with the confidence index rising from -24 points in July, to -3 points. It is possible that mining firms are anticipating an improvement in export activity, in line with better data out of China. Mining firms may also be gaining some confidence about the minerals & resource rents tax being scrapped under a new government. Confidence also lifted sharply in construction (up 16) and finance/ business/ property (up 13), possibly bolstered by an improved outlook for the property market. Confidence was only marginally higher in retail and recreation & personal services. Overall, confidence was weakest in mining (-3) and wholesale (-2), while it was strongest in finance/ business/ property (+12) and construction (+9). It is possible that we are finally beginning to see positive straws emerging from lower borrowing rates and a weaker AUD, while expectations of political change from the upcoming Federal election, more realistically, appear to be the main driver of improved confidence in August.

Business confidence by state. Given political factors driving confidence, it is not surprising that confidence in all states strengthened sharply in August. Confidence rose very sharply in South Australia (up 15), but also picked up strongly in Queensland (up 8), Victoria and NSW (both up 7). The weakest improvement was in WA (up 3 points) where the mining slowdown has clearly spread beyond that sector – and hence WA is facing more structural headwinds than in other states.

The **forward orders** index improved a touch in August, up 2 to -4 points, to be 4 points below the series long-run average since 1989. In levels terms, orders were especially poor in mining (-19), followed by manufacturing (-11) and retail (-9), while they were least subdued in recreation & personal services (zero), construction and finance/ business/ property (both -1). **Capacity utilisation** was little changed at a relatively low level (up 0.1 ppts to 80.0%). This month's outcome largely reflected notable rises in utilised capacity of mining, manufacturing and construction firms, which were broadly offset by declines in transport & utilities, retail and recreation & personal services. In levels terms, capacity utilisation was very low in manufacturing (73.1%) and mining (75.8%), while it was highest in finance/ business/ property (82.5%) and construction (82.4%). The **stocks** index – also a good indicator of current demand – rose solidly in the month (up 4 to -2 points). When combined with still weak trading conditions (-5), the improvement in the stocks index implies that involuntary stocking has commenced.

The **capital expenditure** index rose marginally but, at zero points, remained low relative to recent history. The capex index fell significantly in mining (down 15), where it was the lowest of all industries; this is consistent with the current downturn in mining investment. Capex also weakened considerably in transport & utilities (down 11). In contrast, investment activity appears to have improved a little in manufacturing (up 7), finance/ business/ property (up 6) and retail (up 5). In levels terms, capex was weakest in mining (-21), construction (-10), wholesale (-8) and transport & utilities (-7), while it was highest in recreation & personal services (+7), finance/ business/ property and retail (both +3).

Analysis (cont.)

Based on forward orders, the survey implies 6-monthly annualised demand growth was around 2¼% in Q2 2013, much higher than the actual rate of 0.4%. If we assume that monthly average forward orders for July and August are continued through the remainder of the September quarter, the implied growth rate would be around 2½-2¾%. That is, better than growth in the June quarter but still below trend.

Based on average business conditions for Q2 2013, the survey implies 6-month annualised GDP growth (excluding mining) of around 2¾% in Q2, which is modestly higher than the actual rate of 2.3%. Assuming average monthly business conditions for July and August are continued into the remainder of the September quarter, implied growth would soften compared with Q2 to be around 2½%.

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

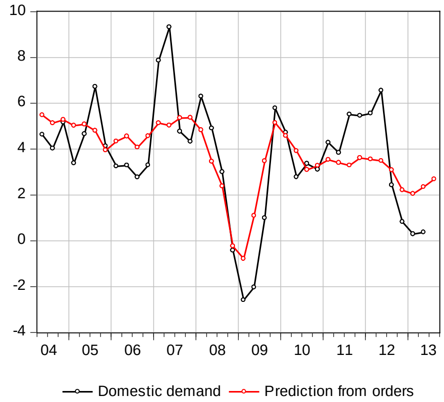
Labour costs growth (a wages bill measure) fell back in August, after rising sharply in July, presumably reflecting the increase in the national minimum wage (while the labour costs series is seasonally adjusted, inconsistent timing of minimum wage decisions throughout history makes data difficult to adjust for this). The pull back in labour costs growth was most apparent for retailers (down 2.1 ppts). Labour costs growth was strongest in transport & utilities and recreation & personal services (both 1.0%, quarterly), while costs fell again in mining (-0.6%), consistent with very poor employment conditions here.

Purchase cost growth ticked down to 0.8% in August (at a quarterly rate), partly unwinding a significant rise in the previous month. While the rate of purchase costs growth eased in August, at 0.8% it is 0.2 ppts points higher than the average over 2013 to date, suggesting the lower AUD is already boosting import prices. There is strong evidence of higher import prices in the wholesale sector – purchase cost growth remained robust at 1.3% in August, following very strong growth of 3.7% in July. Cost growth was also elevated in manufacturing (1.5%), while it was subdued in mining (flat) and construction (0.2%).

Final product prices rose a touch, but remained subdued at 0.1% in August (at a quarterly rate). The softness in prices growth, combined with the elevated pace of purchase costs growth suggests businesses are having difficulty passing on higher costs in the soft demand environment. In fact, purchase costs growth exceeded prices growth for all industries in August. Inflation was highest in wholesale (0.7%, quarterly) and recreation & personal services (0.3%), while price deflation was most apparent in mining (-1.6%), followed by manufacturing (-0.1%). Retail price growth softened a touch, to a subdued 0.1%.

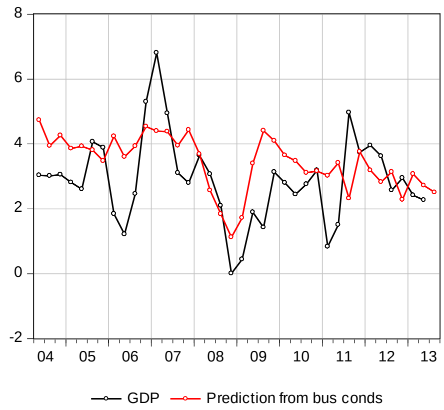
Demand growth to stay below trend

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



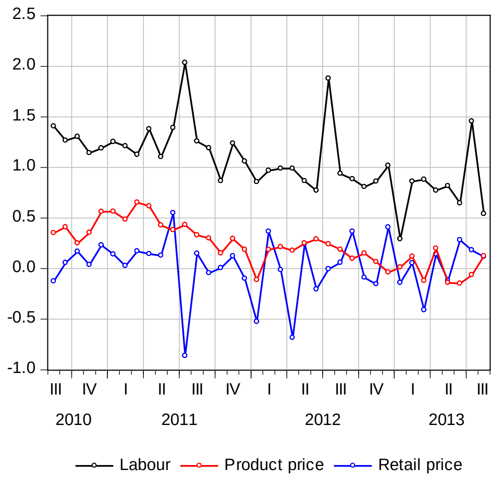
Little sign of a near-term recovery in GDP growth

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



Cost pressures continue to outweigh growth in prices – margins squeezed

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 marginally in August, but remained subdued at -6 points. This outcome is significantly weaker than the long-run average for the series of zero points since 1989. The persistent weakness in business conditions experienced throughout 2013 highlights the inherent weakness in the domestic economic environment.

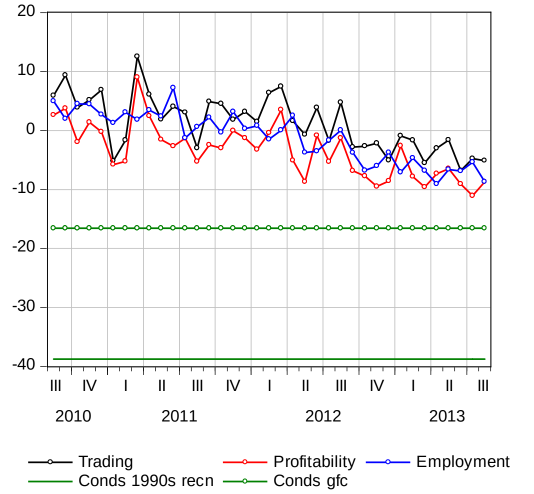
Trading, profitability and employment

The slight improvement in business conditions reflected a marginal improvement in profitability – after this index fell to a 4½ year low in July – which was partly offset by a fall in employment conditions. Trading conditions were unchanged in August.

The only industries to report better **trading conditions** in August were recreation & personal services (up 12) and manufacturing (up 6), which were offset by falls elsewhere. The sharpest falls occurred in mining (down 18), construction (down 7) and retail (down 5). In levels terms, trading conditions were extremely weak in retail (-23), manufacturing (-19), mining and construction (both -16), while they were strongest in recreation & personal services (+24) followed by finance/ business/ property (+1).

Profits improve but still weak, employment slumps to 4 yr low

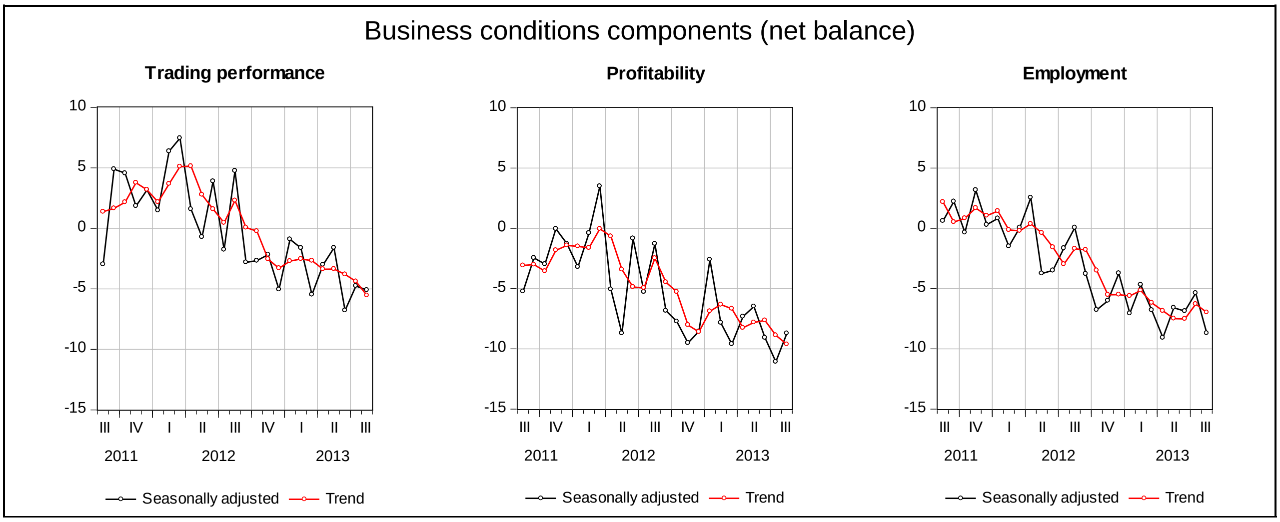
All components of business conditions (net bal., s.a.)



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

The up tick in **profitability** in August largely reflected a rebound in manufacturing profitability (up 21), with this industry possibly starting to benefit from the lower AUD. Profits also strengthened considerably in recreation & personal services (up 10). However, a heavy deterioration in wholesale profitability (down 14), possibly reflecting difficulties in passing on higher import prices, partly offset these gains. Overall, profitability was very weak in mining (-32), wholesale (-24), retail and construction (both -20), while recreation & personal services was the only industry to report a positive profitability reading (+20).

The deterioration in **employment conditions** in August, which more than offset the previous month's rise, largely reflected sharp falls in mining (down 21) and transport & utilities (down 11). As anticipated, the ending of the labour-intensive mining investment phase appears to be taking a toll on employment in this industry. The only industry to report a material improvement in employment conditions was construction (up 8), while conditions were slightly better in manufacturing (up 1). In levels terms, employment conditions were least subdued in recreation & personal services (-2), retail and finance/ business/ property (both -6), while they were weakest in mining (-23), wholesale (-14), manufacturing and transport & utilities (both -13).



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

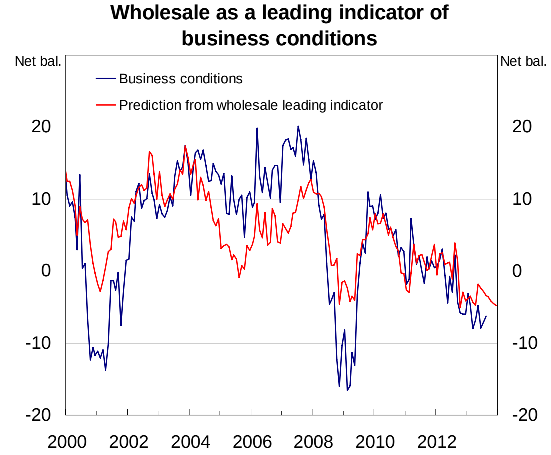
Current business conditions (cont.)

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, wholesale conditions weakened to a subdued -15 points in August.

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 seasonally adjusted wholesale conditions in August (-15) were to continue over the remainder of this year, overall business conditions could be expected to remain poor, averaging -5 index points towards the end of this year. That, in turn, is suggestive of an economy still running well below trend and with little upward momentum in growth.

Wholesale activity points to continued weak conditions



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

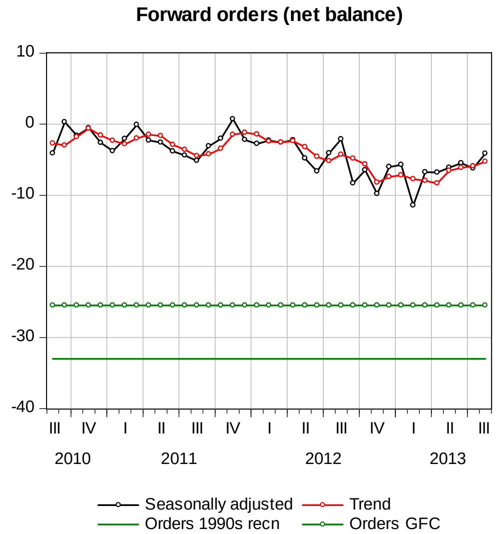
Forward orders

The forward orders index rose to -4 index points in August, up from -6 points in July. This outcome represents the highest level of orders in a year but, at -4 points, is below the series average (of zero since 1989) and implies little near-term improvement in demand.

The rise in orders largely reflected better wholesale orders (up 15), helped by modest rises in finance/ business/ property (up 4) and recreation & personal services (up 3); partly offsetting these improvements was a decline in retail orders (down 5). Orders were most subdued in mining (-19), manufacturing (-11) and retail (-9), while they were least subdued in recreation & personal services (zero), finance/ business/ property and construction (both -1).

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

New orders still weak, but improving

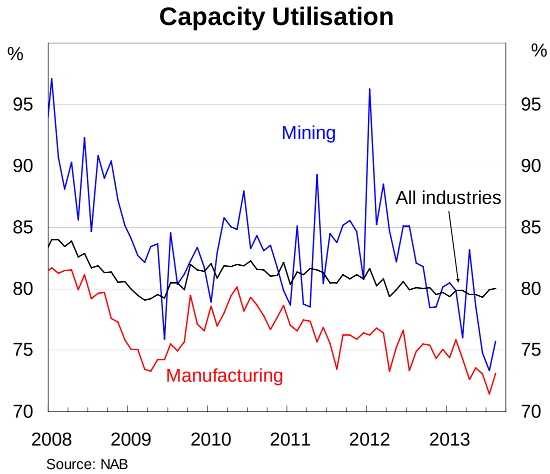


Capacity utilisation

Capacity utilisation rose marginally in August, but at 80.0%, remains at a low level relative to the series average of 80.4% since 1989. This month's outcome reflected solid increases in utilised capacity of mining (up 2.5 ppts), manufacturing and construction firms (both up 1.7 ppts), which were almost entirely offset by declines in transport & utilities (down 1.2%), retail (down 0.9%) and recreation & personal services (down 0.8%). Despite picking up in the month, capacity utilisation remained very low in manufacturing (73.1%) and mining (75.8%), while it was highest in finance/ business/ property (82.5%) and construction (82.4%).

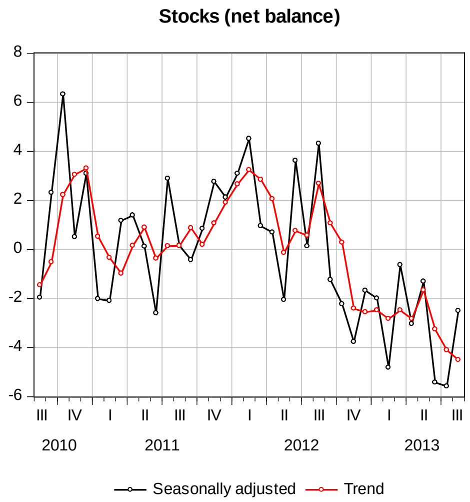
Full capacity is the maximum desirable level of output using existing capital equipment.

Spare capacity still relatively high

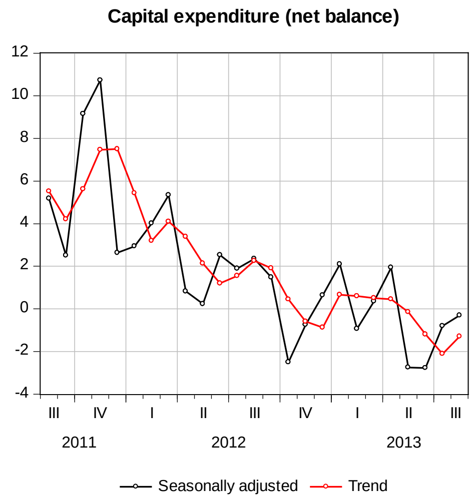


More details on business activity

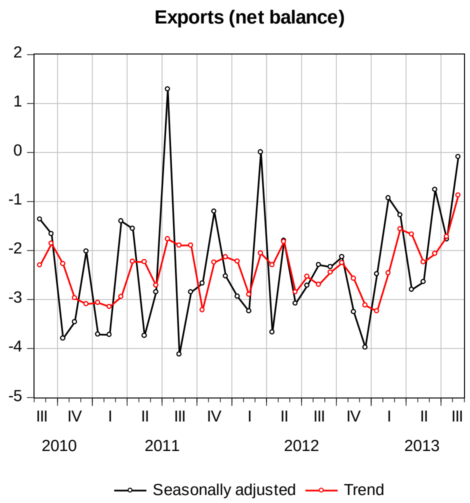
Involuntary stocking commences



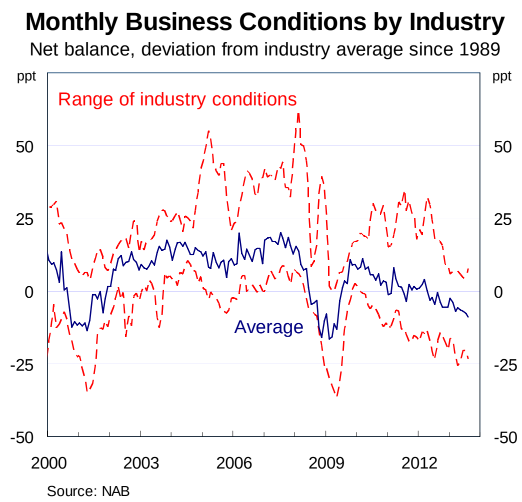
Capex improves but still relatively low



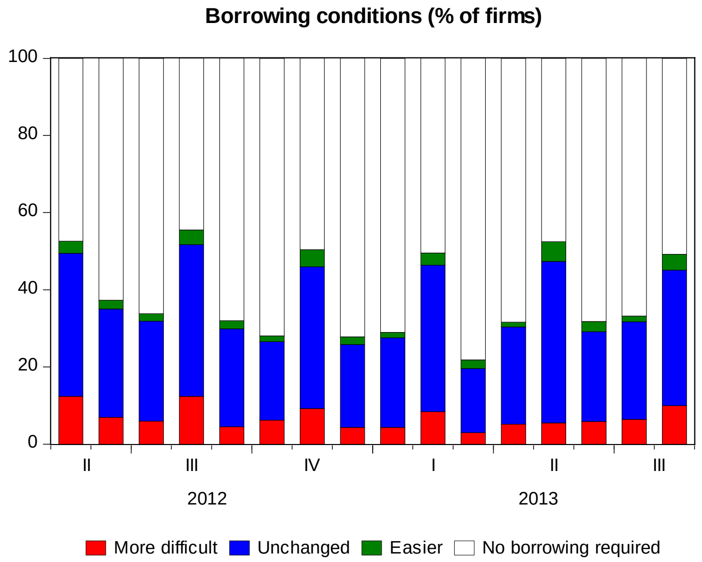
Exports strengthening on lower AUD



Range of industry conditions widens

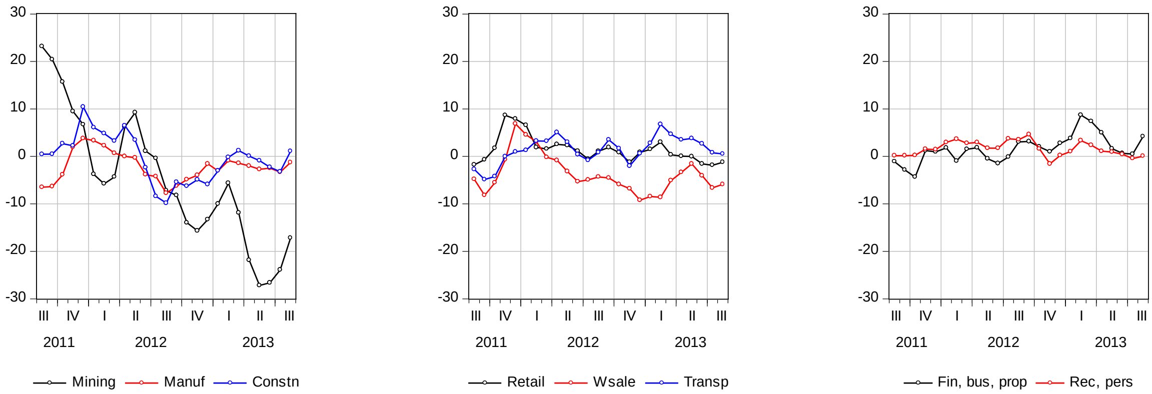


Borrowing conditions tighten, despite lower interest rates

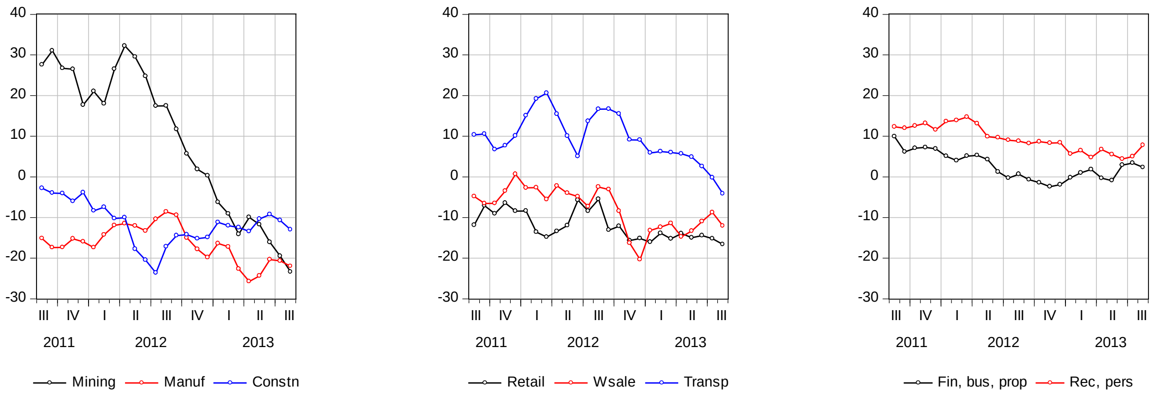


Industry sectors and states

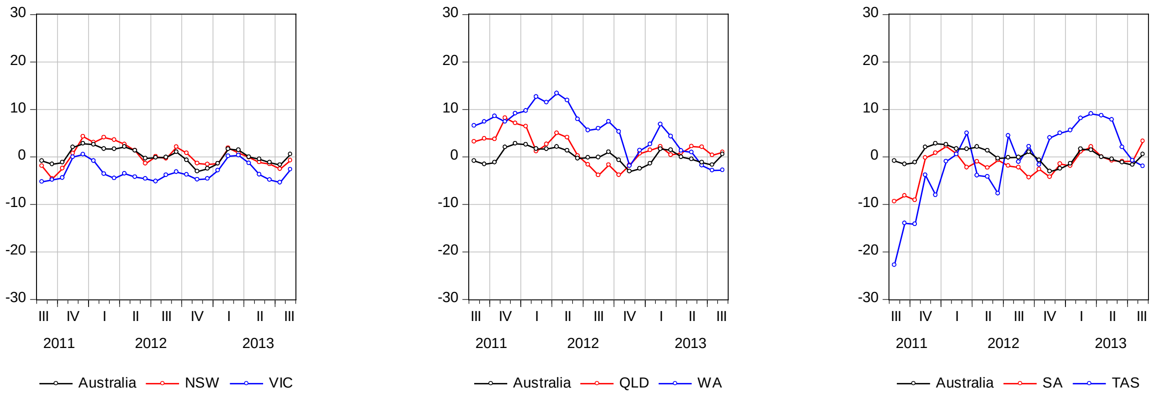
Business confidence by industry (net balance): 3-month moving average



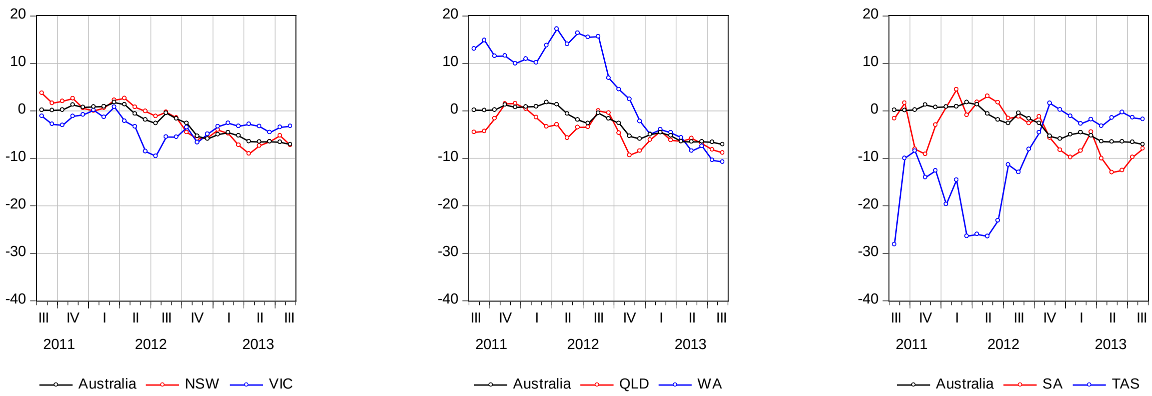
Business conditions by industry (net balance): 3-month moving average



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



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



Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8634 2927
Jacqui Brand	Personal Assistant	+(61 3) 8634 2181
Rob Brooker	Head of Australian Economics & Commodities	+(61 3) 8634 1663
Alexandra Knight	Economist – Australia	+(61 3) 9208 8035
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Gerard Burg	Economist – Industry Analysis	+(61 3) 8634 2788
Robert De Iure	Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
John Sharma	Economist – Sovereign Risk	+(61 3) 8634 4514
Tony Kelly	Economist – International	+(61 3) 9208 5049
James Glenn	Economist – Asia	+(61 3) 9208 8129

Global Markets Research - Wholesale Banking

Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Robert Henderson	Chief Economist Markets - Australia	+(61 2) 9237 1836
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045

New Zealand

Tony Alexander	Chief Economist – BNZ	+(64 4)474 6744
Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Markets Economist, NZ	+(64 4) 474 6923

London

Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+(44 20) 7710 2993
Tom Vosa	Head of Market Economics – UK/Europe	+(44 20) 7710 1573
Gavin Friend	Markets Strategist – UK/Europe	+(44 20) 7710 2155

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+(61 2) 9295 1166
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
Singapore	+(65) 338 0019	+(65) 338 1789