National Australia Bank

Embargoed until:
11:30am Tuesday 10 December 2013

Monthly Business Survey

November 2013

Business conditions and confidence broadly unchanged – with confidence still much higher than conditions. While still weak, business conditions appear to be trending higher. Trading conditions up – especially mining and manufacturing - with capacity utilisation off its recent lows. Against that, the employment index fell considerably – implying further deterioration in unemployment. Forward indicators also generally remain soft – albeit capex improved. Price inflation still moderate but margins under pressure from costs. Rate cut still expected in mid 2014. Unemployment key to how many cut(s) required. Domestic and global forecasts largely unchanged.

- Business confidence edged back a touch in November, suggesting that firms are continuing to reassess their lofty election related expectations given continuing sub par business outcomes. Nonetheless, the changed political environment, more accommodative monetary conditions and rising asset prices are helping confidence. Whether current confidence levels can be maintained given weak forward indicators remains a key question.
- Business conditions are still lacklustre – up a point to -3 points in November. Most interest sensitive sectors improved in the month, but services deteriorated – especially wholesale and transport. Mining conditions also moved off recent lows. But only recreation & personal services (consumers buying services) reports positive (strongly) business conditions – a clear outlier. Forward indicators remain soft with low capacity utilisation levels, no improvement in forward orders and stocks. Employment conditions fell heavily implying further jobs shedding. Falls were especially large in wholesale and finance. In contrast, capex improved, but remains subdued in trend terms.
- Our wholesale leading indicator suggests that below trend growth is likely to continue into the first quarter of 2014. A slightly more optimistic tone however comes from the improving trend in business conditions - implying underlying demand growth (6-monthly annualised) of around 3¼% in Q4 and 2¾% in GDP, above our forecast.
- Labour costs growth has held steady at restrained levels, consistent with the emerging slack in the labour market, while purchase costs growth eased a touch. Overall prices growth softened modestly in November, and when combined with relatively stronger cost pressures, this outcome suggests margins continued to tighten.

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

- Global upturn continues and forecasts little changed. Advanced economies see faster recovery. Chinese and Indian economies faring better. Fed "tapering" in asset buying set to begin in early 2014 but fed funds rates could well be delayed beyond late 2015.
- Australian domestic economy expected to remain weak and growth, while gradually improving, not likely to be jobs-friendly. GDP now forecast at 2.7% (was 2.5%) for 2014 and 3.0% (was 2.9%) for 2015. Critically domestic demand is not expected to significantly exceed 1% over the forecasting period. Unemployment to reach 6½% by late 2014. Rate outlook unchanged with RBA watching economy before another cut in May, although some risk of an earlier or second cut — labour market will be key to watch.

Key monthly business statistics*

	Sep 2013	Oct 2013	**Nov 2013**		Sep 2013	Oct 2013	**Nov 2013**
	Net balance				*Net balance*		
Business confidence	12	6	**5**	Employment	-6	-3	**-8**
Business conditions	-4	-4	**-3**	Forward orders	0	-2	**-2**
Trading	-2	-2	**2**	Stocks	3	1	**0**
Profitability	-4	-6	**-3**	Exports	-1	0	**0**
	% change at quarterly rate				*% change at quarterly rate*		
Labour costs	0.6	0.6	**0.6**	Retail prices	0.3	0.4	**0.4**
Purchase costs	0.7	0.8	**0.7**		*Per cent*		
Final products prices	0.4	0.3	**0.2**	Capacity utilisation rate	80.2	79.3	**79.7**

* 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 25 to 29 November, covering almost 600 firms across the non-farm business sector.

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

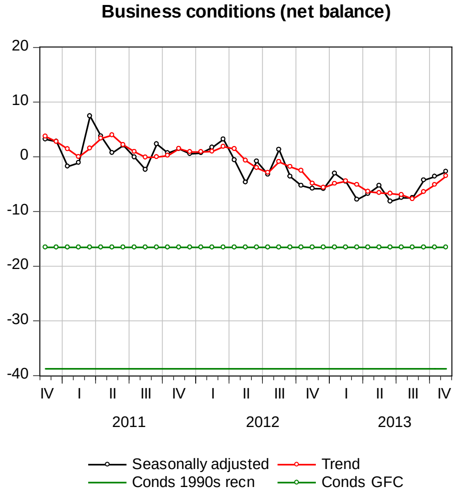
Next release:
28 January 2014 (December monthly)

Analysis

Business conditions, while still below trend, have been trended higher over recent months, supported by the low interest rate environment, higher asset prices and less lofty AUD. While there was a slight improvement in November, lifting 1 point to -3 index points, this level still points to quite subdued business activity and suggests that there has been limited pass-through from the recent vitality in confidence. A number of industries saw an improvement over the month, including mining, manufacturing, construction, retail and recreation & personal services. The largest improvements were in manufacturing and mining, which could suggest that trade exposed sectors are beginning to feel the benefits of an improving global economy and less drag from the AUD. However, the index levels are still very downbeat, while improvements in these industries were largely offset by deterioration in wholesale, transport & utilities and finance/ business/ property firms. Even though some of the headwinds facing exporters and consumer dependent sectors have abated recently, the current business environment remains extremely challenging. Forward indicators remain poor, with forward orders, stocks and capacity utilisation remaining soft. Consistent with this, employment conditions deteriorated to -8 index points, which is close to the lows of mid year and supports our outlook for a weakening labour market.

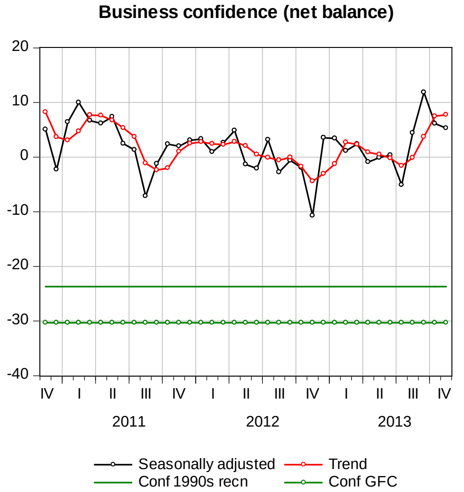
There was a further retreat in **business confidence** from the high recorded in September; the index fell back 1 point to 5 index points in November. Nevertheless, confidence is well above the average for the year (2.6 index points) and is consistent with long-run average levels – supported by post-election jubilation and more favourable monetary conditions. A key question remains whether current levels of confidence can be maintained – with the improvement in conditions best described as tepid at best. Recent partial indicators are also giving mixed signals as to whether business enthusiasm can be sustained. Confidence is positive for most industries, except wholesale which tends to be particularly sensitive to the AUD outlook.

Only gradual rise in conditions



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

Confidence falls back on weak conditions



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 improved strongly in November (up 8), consistent with relatively stable commodity prices in the month, supported by generally positive economic data out of the US and China, although the Fed's prospective QE tapering has been a headwind. Miners may have also had some success in cutting costs with profitability improving, assisted by the lower AUD and weaker employment. Conditions also lifted solidly in manufacturing (up 9) and recreation & personal services (up 5), while construction and retail recorded more modest rises. Conditions in wholesale deteriorated heavily (down 10) – an industry that tends to be a bellwether of future demand – which may indicate some weakness in future conditions. Recreation and personal services continue to outperform other sectors by a considerable margin (followed by finance/ business/ property firms). The falling AUD may be helping to promote domestic travel and other services, but these sectors have also proven to be much more resilient to external headwinds in recent years. Overall, conditions remain extremely weak in wholesale (-13), construction (-11), transport & utilities (-11) and retail (-9).

Analysis (cont.)

Business conditions by state. Business conditions improved in SA, NSW and Queensland, but both WA and Victoria recorded declines (down 7 and 2 respectively). Conditions in SA rose by 5 points, NSW improved by 4 points and conditions in Queensland lifted 3 points. Following these changes, WA has shifted from first to third in the rankings of current business conditions among the mainland states (now at -5 index points), falling behind Victoria (-1 index points) and NSW (-2 index points). Despite the noticeable improvement in conditions for SA, the overall level remains the weakest of all the states (-11 index points).

Business confidence by industry. Changes in confidence during November were mixed across industries. Improvements were recorded for manufacturing (up 5), mining (up 2) and recreation & personal services (up 3), most of which may be gaining some optimism from the falling AUD and expectations for a recovery in the global economy. Despite the recent rises in house prices and building approvals, confidence in construction fell the most in the month (down 4), followed by finance/ property/ business (down 3), retail (down 2) and transport & utilities (down 1). Nevertheless, overall confidence continues to be most positive in transport & utilities (+10) and finance/ business/ property (+9). All other industries continue to be relatively confident, except wholesale (-3), which is the most pessimistic by a significant margin – probably reflecting its particularly high sensitivity to the level of the AUD. A lack of pricing power among wholesalers means that margins are squeezed as the AUD depreciates. In contrast, it is possible that the consumer dependent and property related industries are looking forward to continued improvement in housing market activity. Despite the relative optimism of most industries, forward orders have remained quite subdued, particularly for wholesale, retail and mining.

Business confidence by state. The recent kick in confidence was relatively broad based across the states, but Queensland is the only state to build upon the September gains (up 5 in November). Confidence in all other states barely changed in the month or fell back further from recent highs. Confidence declined most sharply in NSW (down 3), followed by WA (down 2), while Victoria and SA each recorded modest gains. Despite the general pull back, confidence remained positive for all mainland states; Victoria was the least optimistic (+3), followed by NSW (+4), while confidence was highest in Queensland (+11) and SA (+8).

The **forward orders** index remained unchanged at -2 index points, which is close to the highest levels seen since 2011, but still points to relatively subdued activity in coming months. By industry, a sharp deterioration in transport & utilities (down 12), retail (down 11) and wholesale (down 6) was offset by solid improvements in construction (up 8) as well as services. Forward orders are highest in finance/ business/ property (+8 index points), followed by construction (+5 index points), while wholesale continues to be the weakest (-17). **Capacity utilisation** has improved somewhat – albeit from the equal lowest level since June 2009 in October (up 0.4 ppts to 79.7%). Current readings for capacity utilisation are significantly below the long averages and imply a considerable slack in the economy – which will continue to depress business investment for some time. This month's outcome reflected improvements across most industries, offsetting declines in recreation & personal services (down 1.9) and wholesale (down 1.1). Manufacturing recorded the largest increase in capacity utilisation, following its lowest level on record last month. That said, with capacity utilisation of just 76.1% business investment in manufacturing is likely to remain very depressed for a long period – consistent with subdued investment intentions by manufacturers in both our own business survey and the ABS Capex survey. In levels terms, capacity utilisation was lowest in mining (75.0%), while it was highest in financial/ business/ property (83.1%), construction (81.7%) and wholesale (81%).

The **stocks** index – also a good indicator of current demand – fell by 1 point to a net balance of zero, indicating that there was adequate production to meet the improvement in trading conditions for the month. Furthermore, the fall in forward orders may have prompted firms to limit the amount of inventory accumulation in the face of a soft demand outlook.

The **capital expenditure** index rose by 9 points to 5 index points – the highest reading since March last year. The capex index rose across all industries, with transport and utilities (up 12) and mining (up 11) reporting the biggest increases. The capex index also rose considerably in recreation & personal services (up 9) and retail (up 8). In levels terms, capex was highest in finance/ business/ property (+11) and transport & utilities (+11), while it was lowest in construction (-13) and mining (-8). However, the capex series is quite volatile and remains relatively subdued in trend terms. Trends in this series will be interesting in coming months – with a sustained increase necessary for any pick up in non mining investment.

Analysis (cont.)

Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has been suggesting stronger growth in recent quarters than the national accounts. However, the accuracy of the model did improve in Q3 with actual growth picking up to 2.1%, compared to the models prediction of 2%. If we assume the November trend forward orders outcome is continued into Q4, the implied demand growth would strengthen further to around 3¼%, but this is well above our forecast. It is also not consistent with our wholesale based leading indicator of business conditions (see below).

Based on average business conditions for the September quarter, the survey implied 6-month annualised GDP growth of around 2¾% in Q3, close to the actual growth rate in the national accounts. Based on trend business conditions from the November Survey, the survey implies GDP growth will remain around 2¾% in Q4, also above our forecast.

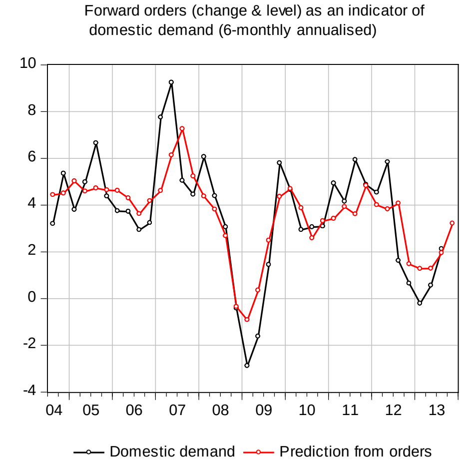
Elsewhere in the survey, cash flow (not seasonally adjusted) was strongest in recreation & personal services, and weakest in mining and manufacturing.

Labour costs growth (a wages bill measure) was unchanged in November at subdued levels. This reflected softer labour cost pressures in wholesale (down 0.6 ppts), mining (down 0.3 ppts) and fin/ bus/ prop (down 0.1 ppts), offset by modest increases in manufacturing, transport & utilities, recreation & personal services and retail labour costs growth (all 0.1 to 0.2 ppts higher). Labour costs growth was strongest in transport & utilities (1.1%), recreation & personal services (1.0%), and fin/ bus/ prop (0.8%), and softest in mining (0%), and wholesale (0.2%).

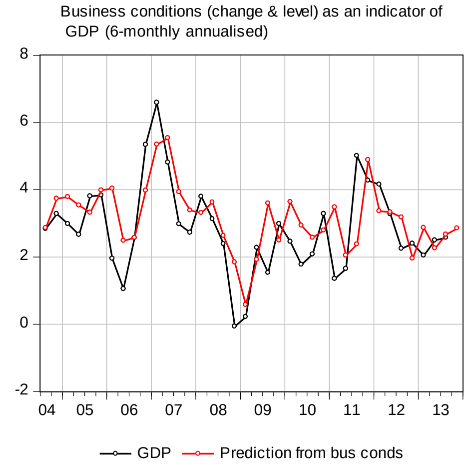
Purchase cost growth decreased a touch to 0.7 ppts in November (at a quarterly rate), unwinding a tick up in growth in the previous month. Purchasing costs eased despite a steady depreciation of the AUD over the month of November (around 4% depreciation), although this can take some time to pass through to costs. Purchase cost growth was strongest in manufacturing (1.1%, at a quarterly rate), retail (1.0%) and wholesale (0.9%), while purchase costs increased more marginally for mining and financial/ property/ business services (both 0.3%).

Final product price growth was broadly unchanged in November, suggesting that consumer price inflation should stay off the RBA's radar for the time being. Nevertheless, at 0.2% (quarterly rate), price inflation remains slightly more elevated than average growth over the previous two years (of 0.1%), but is still well below the series average of 0.5%. Across industries, the mining sector is continuing to experience price deflation (-1.5%), while deflation in construction has eased (-0.1%). Prices increased most strongly in fin/ bus/ prop services (0.5%), followed by retail (0.4%) possibly reflecting previous AUD depreciations and stronger rises in purchase costs.

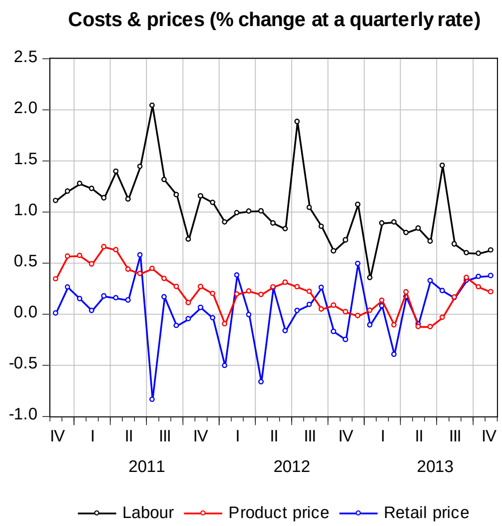
Demand growth rising, but staying below trend



GDP growth to remain soft in Q4



Prices growth softens and still outpaced by rising costs



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 was slightly stronger at -3 points in November. This is still a uninspiring outcome given the recent strength in business confidence, and suggests that domestic demand growth is likely to remain below trend, putting pressure on the labour market. This outcome remained below the series long-run average of zero points since 1989, and well-below the monthly survey average of +5 points since 1997.

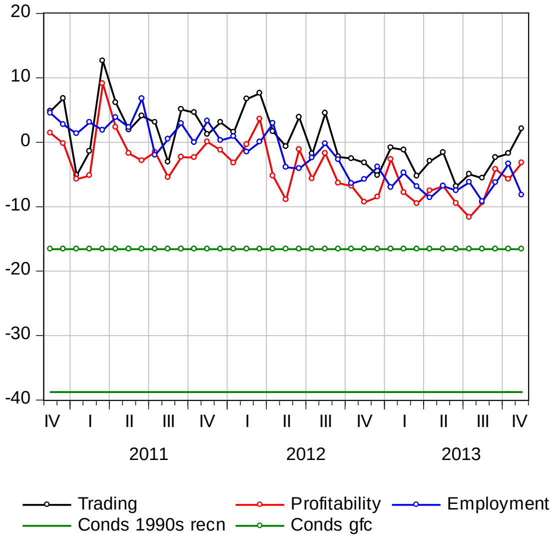
Trading, profitability and employment

The slight improvement in business conditions reflected better profitability and trading conditions, which have been steadily improving since mid-year, although these were largely offset by a significant deterioration in employment conditions. Nonetheless, each of these components remained below average levels.

There were significant improvements in **trading conditions** for manufacturing (up 17), recreation & personal services and mining (both up 11), while they deteriorated considerably in wholesale (down 8) and transport & utilities (down 7). In levels terms, trading was still poor in mining (-12), despite the sharp improvement for the month, as well as retail (-9), wholesale (-9) and construction (-6). Conditions are much better in recreation & personal services (+21).

Trading conditions & profits pick up but employment deteriorates

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

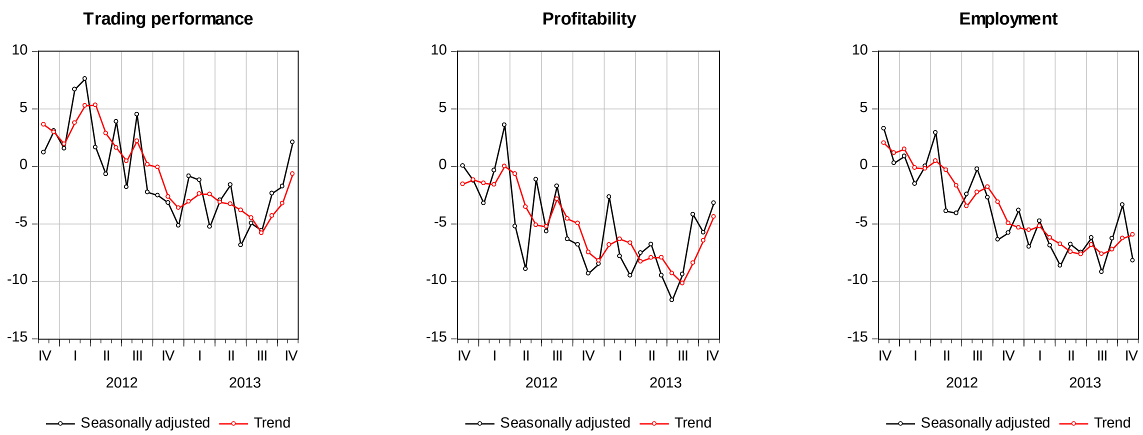


Net balance of respondents who regard last month's trading / profitability / employment performance as good.

The deterioration in **employment conditions** pushed the overall index close to its lowest level since 2009, largely reflecting a sharp contraction in wholesale employment (down 19). Employment conditions also weakened considerably in financial/ property/ business (down 12) followed by mining (down 4). Manufacturing (up 7), transport & utilities (up 6) and retail (up 1) each reported stronger employment conditions in the month. In levels terms, employment conditions are by far the weakest in wholesale (-25), then construction (-13) and financial/ property/ business (-10). Mining is the only industry still reporting positive employment conditions (+3) highlighting the emerging difficulties in the labour market.

Profitability improved in November, but remains relatively subdued - as a result soft demand and rising costs are squeezing margins. The advance in profitability was relatively broad based, although transport & utilities (down 12) and wholesale (down 6) both recorded declines. The strongest pick up came from mining (up 14), although construction and rec & personal services both recorded solid increases (up 9). In levels term, profitability was extremely weak in transport & utilities (-19) and manufacturing (-16), while rec & personal services (+13) and fin/ bus/ prop (+3) are the only industries in positive territory.

Business conditions components (net balance)



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

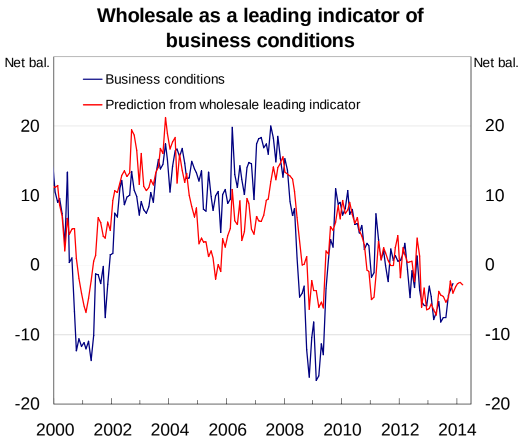
Current business conditions (cont.)

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 trend conditions remained subdued, at -9 points in November.

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 trend conditions in November (-9) were to continue over the remainder of this year, overall business conditions could be expected to remain poor, averaging -3 index points towards the end of this year. That in turn suggests 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))

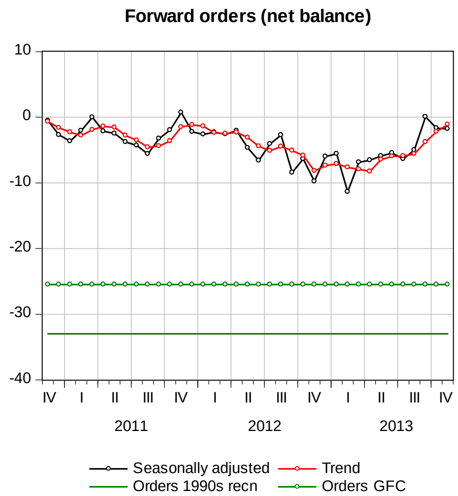
Forward orders

The forward orders index was unchanged at -2 points in November. At -2 points, the index is now marginally below the series long-run average of zero points since 1989. Nonetheless, the index is higher than the index average of the past two years (-5 points).

No change in orders reflected large falls in transport & utilities (down 12), retail (down 11) and wholesale (down 6) orders, offset by more moderate increases in other industries, with construction increasing the most (up 8). Orders were strongest (and positive) in finance/ business/ property (+8), and weakest in wholesale (-17), retail (-12) and mining (-11).

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

New orders fall from two year high

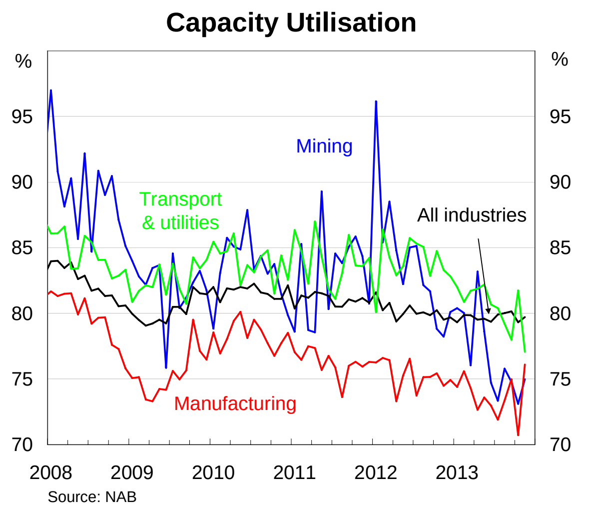


Capacity utilisation

Capacity utilisation recorded a solid increase in November (up 0.4 ppts to 79.7%), following a sharp decline in the previous month. Despite the improvement, this level of capacity utilisation is still low relative to the monthly survey average of 81.1% (since 1997), and the long-run average of 80.4% (since 1989). This month's outcome reflected a solid pick up in manufacturing (up 5.4 ppts) and construction (up 2.5 ppts), which along with more modest increases in other industries more than offset a sharp decline in transport & utilities (down 4.7 ppts) and smaller falls in other industries. Mining and manufacturing capacity utilisation remains very low (75% and 76.1%). Utilised capacity was highest in fin/ prop/ bus (83.1%).

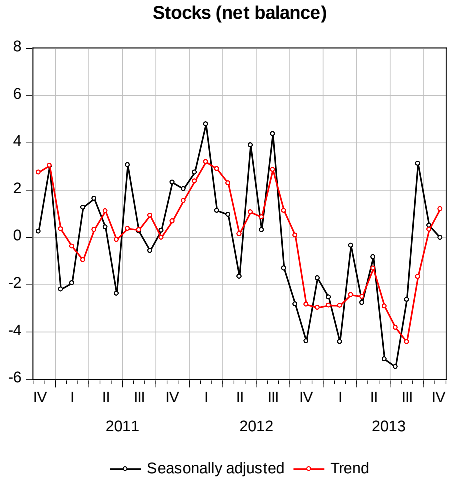
Full capacity is the maximum desirable level of output using existing capital equipment.

Capacity usage low in manuf. & mining

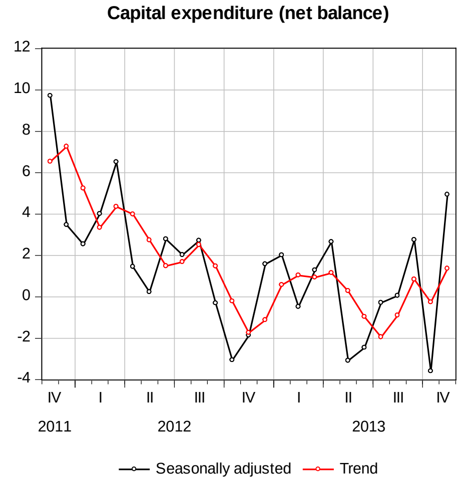


More details on business activity

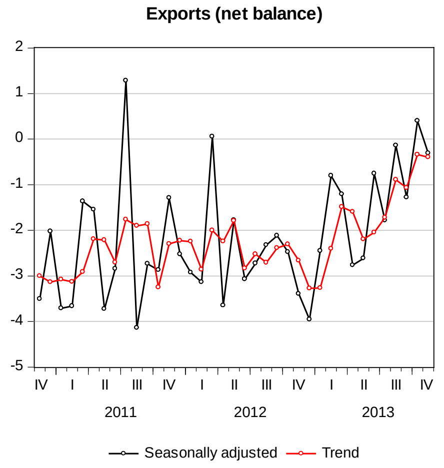
Weak orders preventing re-stocking



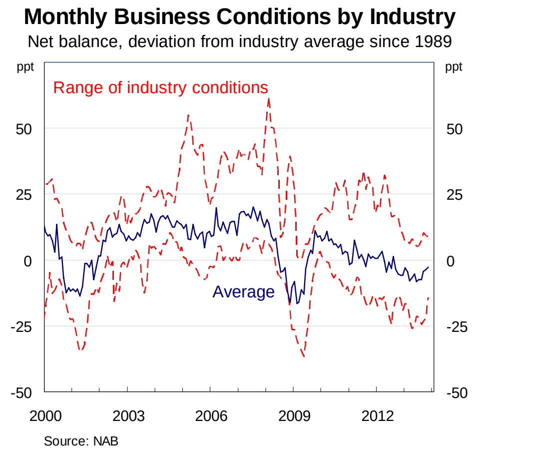
Capex rises, especially in mining



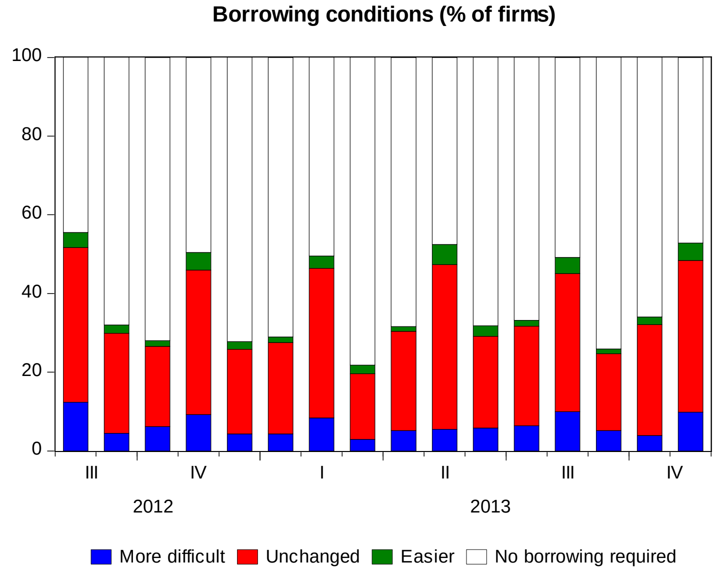
Exports better, but still soft



Range of industry conditions still wide



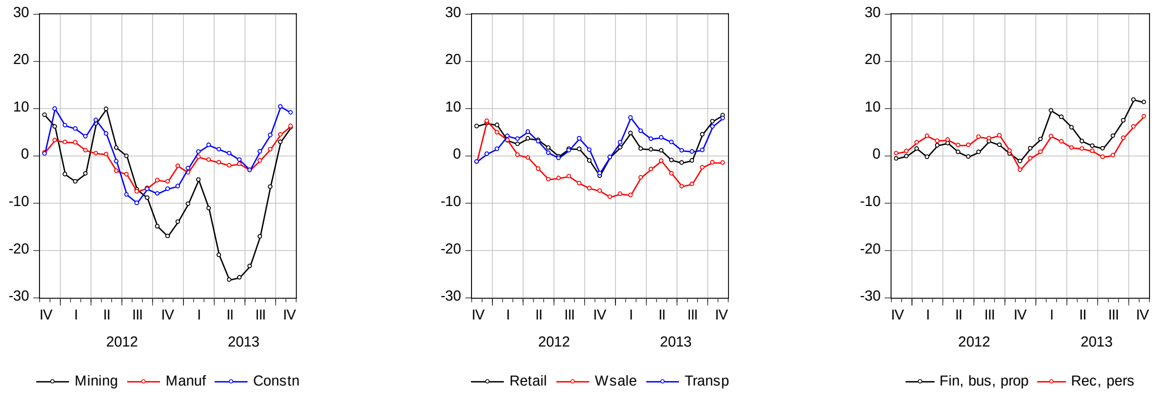
Borrowing conditions tighten for some and demand for credit increased



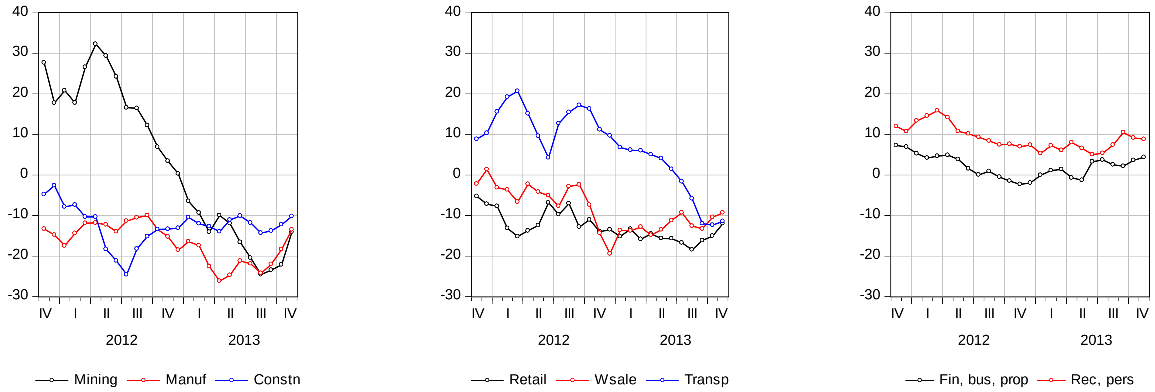
Embargoed until 11:30am Tuesday, 10 December 2013

Industry sectors and states

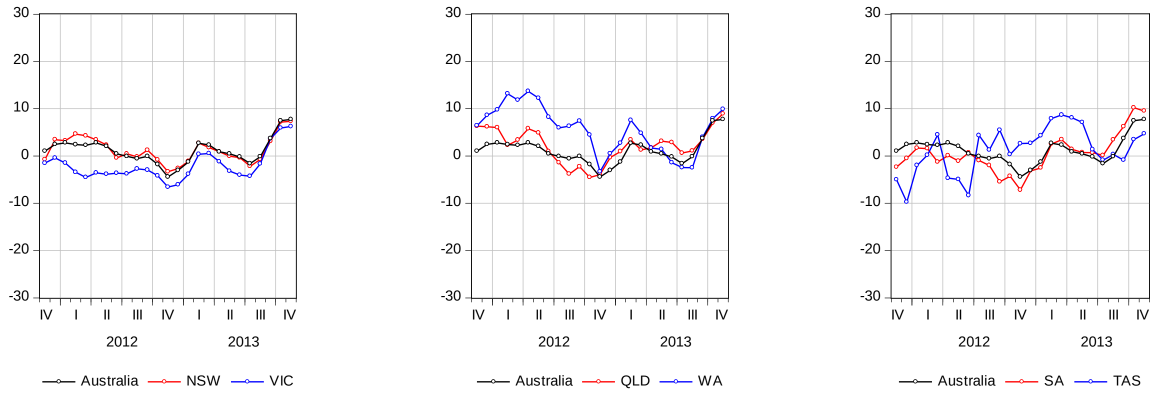
Business confidence by industry (net balance): 3-month moving average



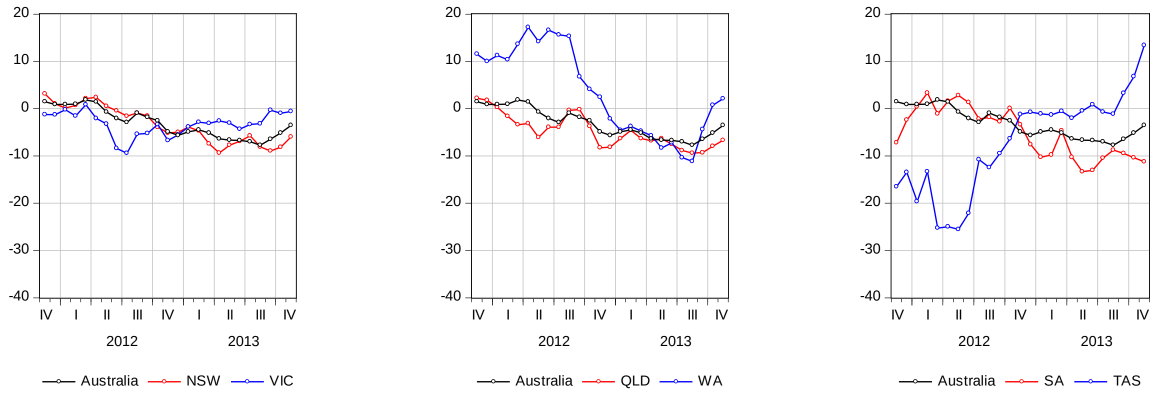
Business conditions by industry (net balance): 3-month moving average



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
James Glenn	Economist – Australia & Commodities	+(61 3) 9208 8129
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Vacant	Economist – Industry Analysis	NA
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
Gerard Burg	Economist – Asia	+(61 3) 8634 2788

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