National Australia Bank

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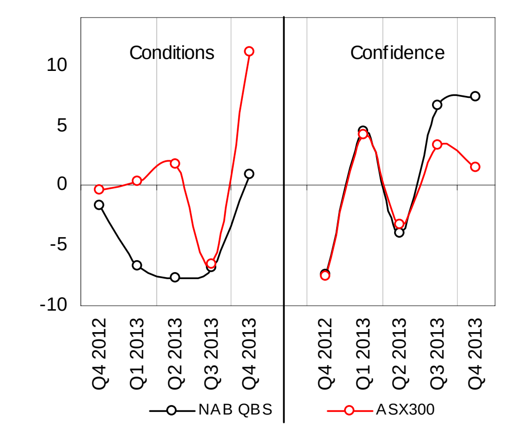
Quarterly ASX 300 Business Survey December 2013

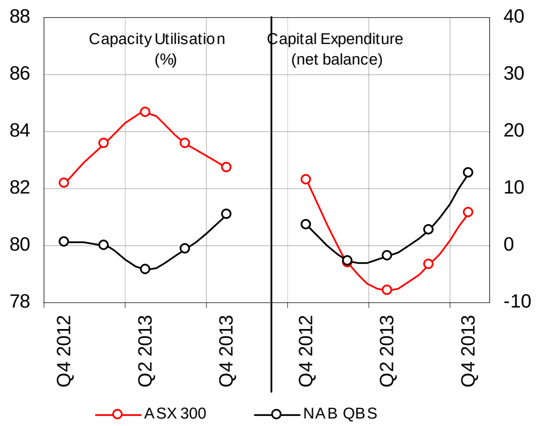
Business conditions for larger firms improved significantly in the December quarter – outperforming firms in the broader economy. However, confidence weakened slightly for larger firms – dropping below conditions and breaking away from the exuberance of the broader economy. Employment and capital utilisation remain soft, but orders and capex plans are up. Cost pressures subsided, helping margins.

- Business conditions for ASX 300 surged 18 points to +11 points in the December quarter of 2013, (from -7 points in the previous quarter) – the highest rate since Q1 2011. This was a stronger improvement than conditions for the broader economy which also improved to +1 points in the quarter (up from -7 points in Q3). Most industries improved, but retail, transport & wholesale recorded the strongest rise. Recreational services was the only exception, recording a fall.
- The sudden jump in business conditions for larger firms was primarily driven by improvements in trading and profitability. Employment also trended upwards for both the broader economy and ASX 300, but remained in contractionary territory.
- Despite the overall jump in business conditions, confidence for larger firms softened — contrasting the broader economy where confidence was unchanged at elevated levels. ASX 300 confidence declined to +1 (from +3 points), while the broader measure of confidence remained at +7 points.
- In line with the broader economy, larger firms benefited from diminished costs - as labour, overhead and purchase costs decelerated in the December quarter.
- Consistent with reported improvements in sales, large firms took advantage of lower input costs to help restore their margins, which have been under pressure for some time – albeit to a lesser extent than the broader economy.
- Capital expenditure for larger firms bounced back from the September quarter, reaching its highest level since this time last year. Capex outcomes varying starkly between industries. Manufacturing gained momentum and retail held up. Wholesale, construction and recreation services are very weak.

Business conditions & confidence (net balance, nsa)



Capacity utilisation and capital expenditure



Key quarterly business statistics**

	ASX 300 Q3 2013	ASX 300 Q4 2013	NAB QBS Q4 2013
		Net balance	
Business confidence	3	1	7
Business conditions			
- Current	-7	11	1
- Next 3 months	3	9	6
- Next 12 months	18	22	24
Capex plans (next 12)	7	23	20
		% change	
Labour costs	0.39	0.25	0.37
Purchase costs	0.39	0.20	0.40
Final product prices	0.16	0.16	0.16

	ASX 300 Q3 2013	ASX 300 Q4 2013	NAB QBS Q4 2013
		Net balance	
Trading	-4	17	6
Profitability	1	17	1
Employment	-16	-1	-4
Forward orders	2	9	0
Stocks	0	7	6
Export sales	7	6	1
		% change	
Retail prices	0.27	0.46	0.24
		Per cent	
Capacity utilisation rate	83.6	82.7	81.1

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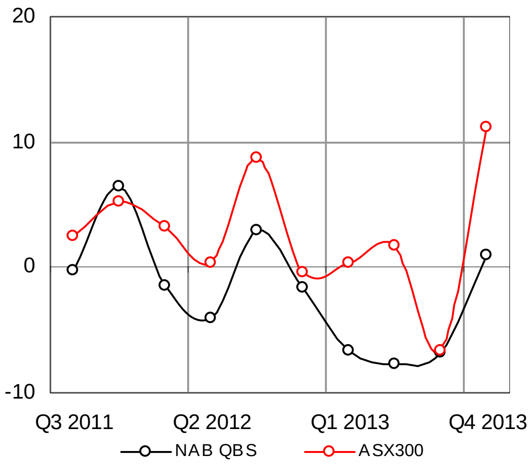
** All data non-seasonally adjusted. Cost and prices data are percentage changes expressed at a quarterly rate. All other data are net balance indexes, except capacity utilisation, which is an average rate, expressed as a percentage. Fieldwork for this Survey was conducted from 25 November to 13 December 2013.

Analysis

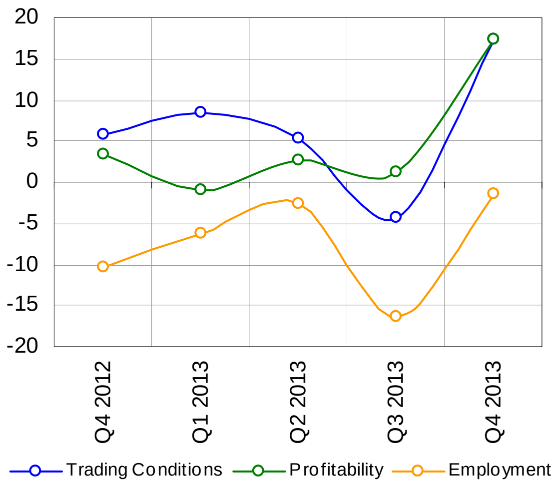
Conditions elevated in Q4 for both ASX 300 and the broader economy

Business conditions (net balance, nsa)



Improved conditions across all the major components

Business conditions components (net balance, nsa)



Business conditions for Australia's largest firms bounced back significantly in the December quarter, rising to +11 points – the highest rate experienced by the larger firms since Q1 2011. This outcome was similar to the improvement seen in the broader economy, where conditions increased to +1 points in Q4 (from -7 points) – although the spread in conditions (favouring larger firms) is the largest it has been since at least Q1 2011. The improvement in business conditions was relatively broad based across industries, although recreation services were the main exception, deteriorating in the quarter. Retail was the biggest driver of the increase (see page 7).

Expected conditions for ASX 300 firms improved in line with the broader business survey (both 3-month and 12-month ahead expectations).

Coupled with a lower AUD and interest rates, the stronger upward trend in business conditions for larger firms was primarily driven by improvements in trading and profitability: both up to +17 points (from -4 and +1 points in Q3 respectively) – softening costs contributing to the latter. Employment also lifted for both the broader economy and ASX 300, but remained in contractionary territory – with the ASX 300 at -1 point and for the overall economy at -4 (up from -16, -9 points respectively).

net balance	Conditions – current	Conditions – next 3 months	Conditions – next 12 months	Confidence – next 3 months
ASX 300	11	9	22	1
NAB QBS	1	6	24	7

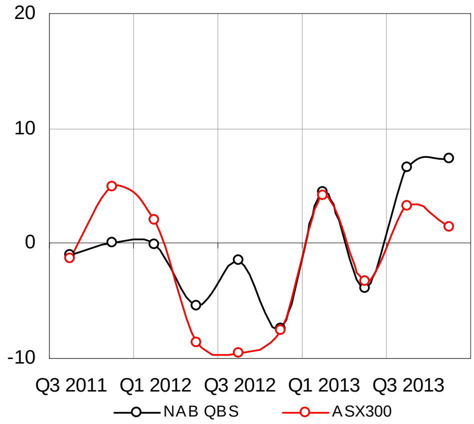
In contrast to business conditions, **confidence** among ASX 300 weakened slightly for the December quarter, edging down to +1 point (from +3 points in Q3). For the broader economy, confidence remains unchanged at +7 points.

Some disparity exists between surveys, with ASX 300 reporting deterioration in the mining industry (-11 points for Q4, down from +9 points), while conditions reported by mining firms in the broader Quarterly Business Survey (QBS) improved (up to -6 points from -12 points in Q3). Nevertheless, conditions are soft across the board for mining.

Similarity, the wholesale industry – considered a bellwether of the economy – has been soft and deteriorated further in Q4 for both larger firms and those in the QBS – declining to -21 points and -1 point (down from 5 points and 4 points in Q3 respectively). For larger firms, confidence in transport services improved slightly.

Confidence trends downwards for ASX 300 in Q4; unchanged in QBS

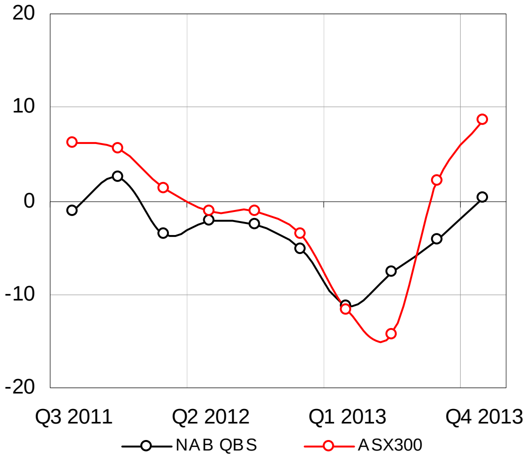
Business confidence (net balance, nsa)



net balance	Trading Conditions	Profitability	Employment	Sales margins	Forward orders	Stocks
ASX 300	17	17	-1	-1	9	7
NAB QBS	6	1	-4	-9	0	6

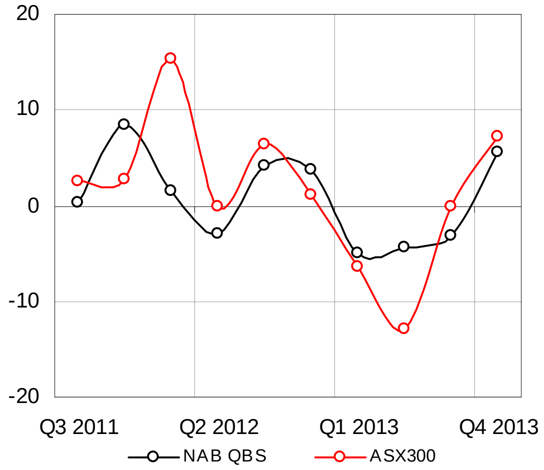
Forward orders strengthened for ASX 300

Forward Orders (net balance, nsa)



ASX 300 and QBS stock levels jump in Q4

Stock levels (net balance, nsa)

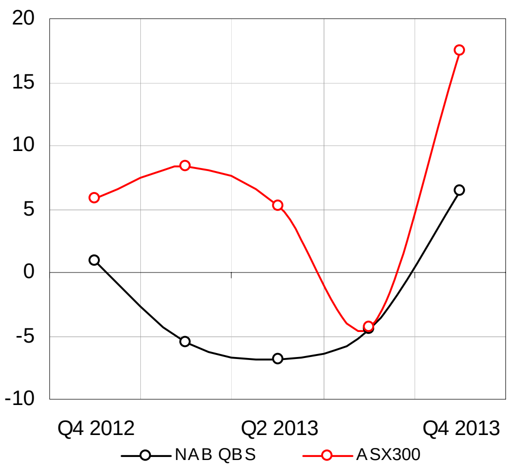


As a leading indicator, the improvement in forward orders point to strengthening conditions for larger firms in the economy – the highest level of orders since at least Q1 2011, far outpacing those seen in the broader economy (see page 8).

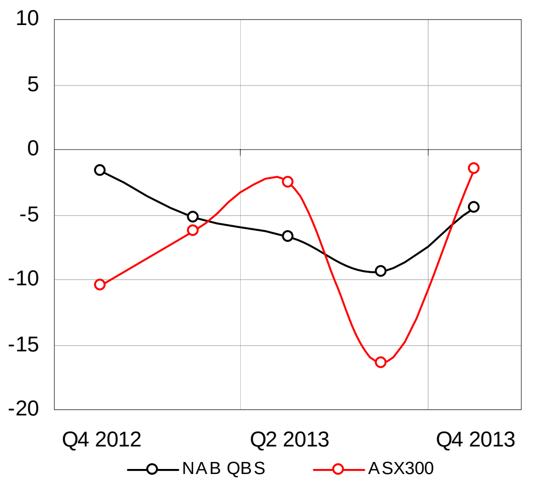
Stock levels also gained momentum increasing to +7 points in Q4 (0 previously), with manufacturing increasing the most. Likewise for the broader economy, stock levels trended upwards, strengthening to +6 points in the fourth quarter. This could suggest a voluntary restocking in anticipation of improving sales. Expectations for stock building in the short term dropped.

Trading conditions strengthen much more for larger firms; employment a little better for larger firms, but still soft

Trading conditions (net balance, nsa)



Employment conditions (net balance, nsa)



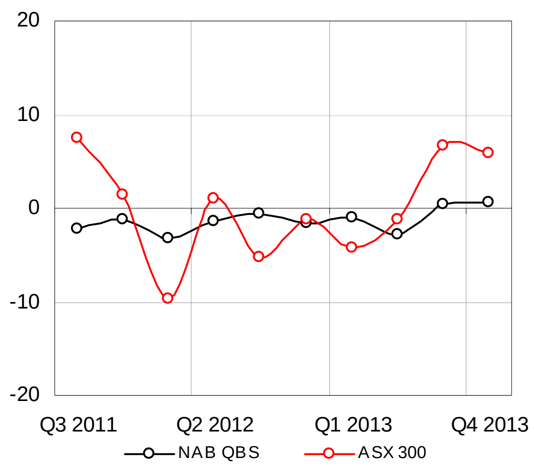
Trading conditions experienced by larger firms were at their highest since at least the first quarter of 2011. Retail surged 60 index points to +43 points (up from -17 in the September quarter).

Coupled with the lower exchange rate and easing cost pressures, construction and wholesale experienced an upturn in trading conditions. There was a modest improvement in conditions for electricity, water & gas. In sync with the broader economy, the positive trend in trading conditions is expected to flow into the near and long term for larger firms.

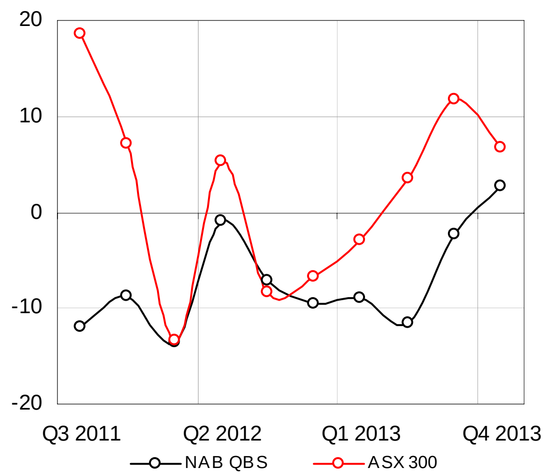
Employment conditions of the ASX 300 improved noticeably in the quarter, but remain quite soft – pointing to ongoing increases in the unemployment rate over coming quarters. The index rose 15 points in the quarter to -1 index point, which is marginally higher than employment conditions facing the broader economy (-4 points), although they too saw an improvement in the quarter.

Exporters benefiting from improved global economic environment – although momentum eased. Larger firms outperforming broader economy

Export Sales (net balance, nsa)



Export Orders (net balance, nsa)



Exporters in the ASX 300 reported positive sales for the second consecutive quarter in Q4, supported by the improving global economic environment and more accommodative AUD relative to recent history. However, the momentum did appear to ease slightly with the ASX 300 export sales index easing by 1 point to +6 index points. Export sales continue to be particularly good for transport, as well as manufacturing retail and wholesalers.

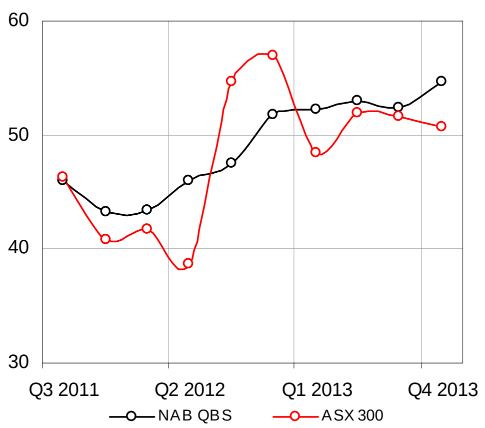
By comparison, export sales in the broader economy have remained relatively muted (+1 point), although they have picked up from the deterioration reported mid-year – driven largely by manufacturers supported by the lower AUD.

External demand is expected to be supportive in the near-term, although expectations for the coming three months have been pared back from what ASX 300 firms had been reporting in previous quarters.

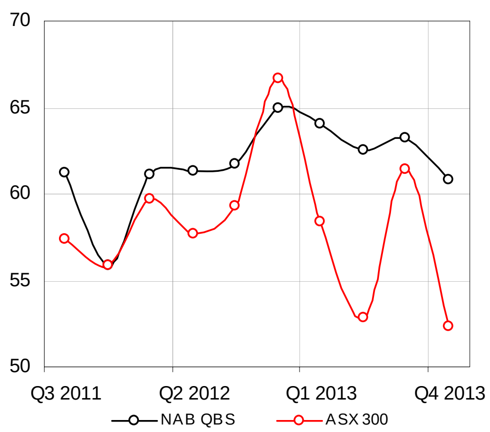
Softer export sales expectations have been reflected in a slight pull-back in export orders, although they have remained positive (down 5 to +7 points) and continue to outperform the broader economy (although the latter appears to be catching up).

Despite slight improvement, demand remains a concern for profitability

Main constraint on profitability (% of firms) - Demand



Constraints on output (% of firms) – Sales & Orders

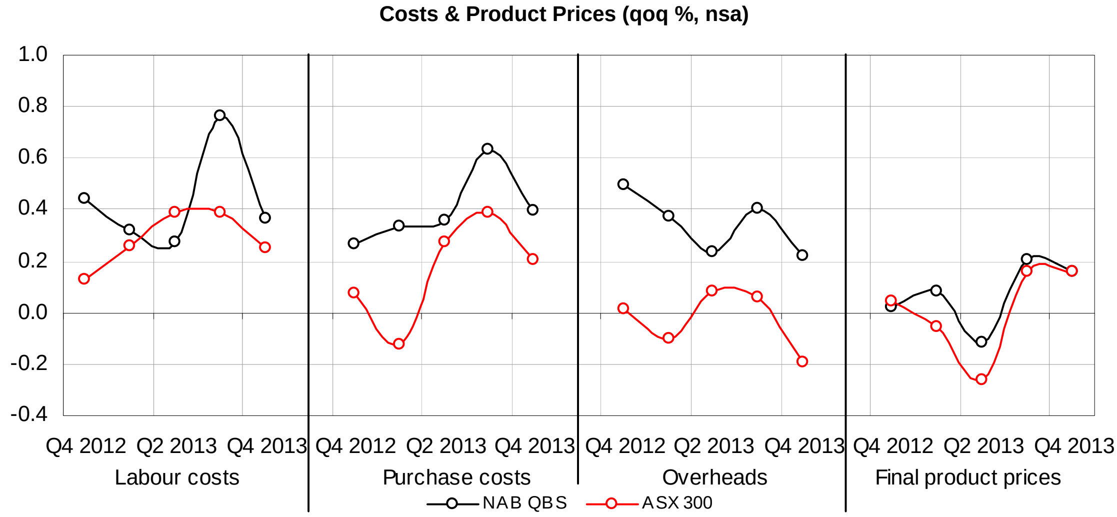


Despite the slight improvement in the December quarter, demand has remained a major constraint on profitability as reported by larger firms – consistent with trends seen in the broader economy. Amongst the respondents, 51% agreed that demand was still the major constraint on profitability (in comparison to 52% in the previous quarter). This constraint on profitability became more common in the quarter for the broader economy, at 55% compared with 52% recorded in Q3.

Compared with the September results, sales & orders as a constraint on output eased modestly but still remains the predominant concern, with 52% of respondents to ASX 300 and 61% for QBS concurring.

Of all the other potential constraints on output, labour availability continues to rank quite highly (almost 30% of respondents), despite the slack that has developed in the labour market (the unemployment rate recently reached 6%, surpassing the peak seen during the Global Financial Crisis). Plant & premises, as well as availability of finance/working capital are common responses (19% and 18% of respondents respectively).

Cost pressures eased for larger firms in Q4 – similar to broader economy

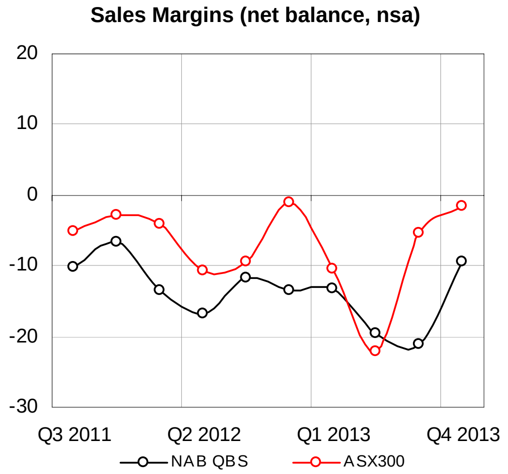


Cost pressures eased off larger firms in the December quarter, with labour cost growth easing to 0.25%. Purchase costs and overheads also edged down to 0.20% and -0.19% respectively. Despite the easing in cost pressures, final product prices were flat at 0.16%, suggesting that firms are taking advantage of improving demand and easing costs to restore margins – the discounting cycle looks to have ended.

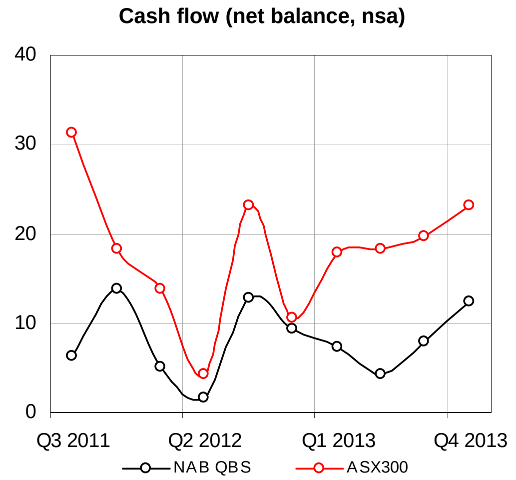
In comparison to the ASX 300, the overall economy also experienced diminished cost pressures in the fourth quarter – labour, purchase and overhead costs all decelerated to 0.37%, 0.40% and 0.22% respectively. Final product prices also eased back - down to 0.16% (from 0.2% in Q3).

In spite of the downward trend in purchase and overhead costs, a modest increase is expected for ASX 300 labour costs in the near term. In comparison, short term prospects for costs in the broader economy are expected to remain slightly more subdued.

Sales margins improved for ASX 300 in Q4 – inline with QBS



Cash flow for ASX 300 at its highest level since Q3, 2012



Both surveys reported a modest up-tick in sales margins for the December quarter – ASX 300 improving to -1 points (from -5) and -9 points for QBS (up from -21). Firms may now be taking advantage of softer costs growth to repair margins (or at least prevent them from deteriorating further).

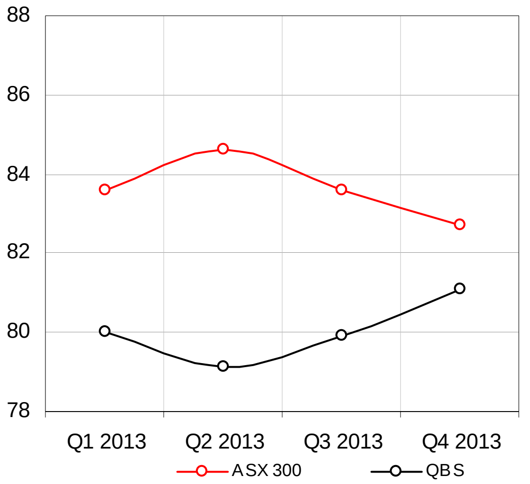
For larger firms, construction, retail and transport services reported the largest improvement in the index from last quarter, but margins appear to be healthiest for transport/ utilities/ communications, retail and manufacturing. A majority of industries in the broader economy are still reporting quite poor margins – Communications is the only industry to report a positive index.

The upward trend in cash flow continued into December quarter, increasing for larger firms to +23 points, (up from +20 points in Q3), with construction and retail the main drivers of the change – cash flows are reported to be best in retail and wholesale. This continued improvement is also evident for the broader economy - growing for the last three quarters of 2013, yielding +12 points in the December quarter.

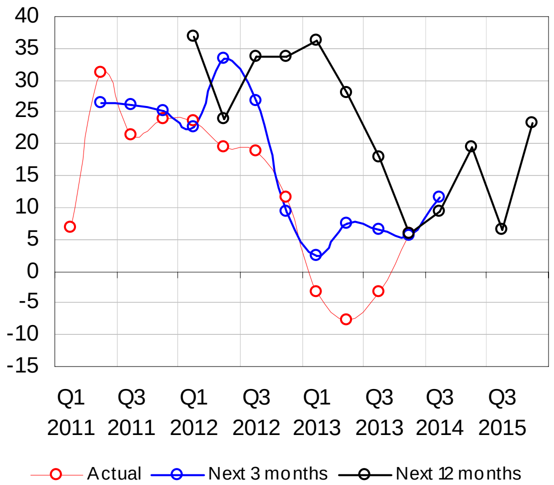
In the short term, ASX 300 firms became more optimistic about projected cash flows over the short term (rising to +25 points, from +14), with most industries reporting more favourable expectations. Stronger short term expectations were also reported for the broader economy.

Capacity utilisation slowing, in contrast to broader economy. Rising activity helping the CAPEX outlook

Capacity Utilisation



Capital Expenditure incl. Projections

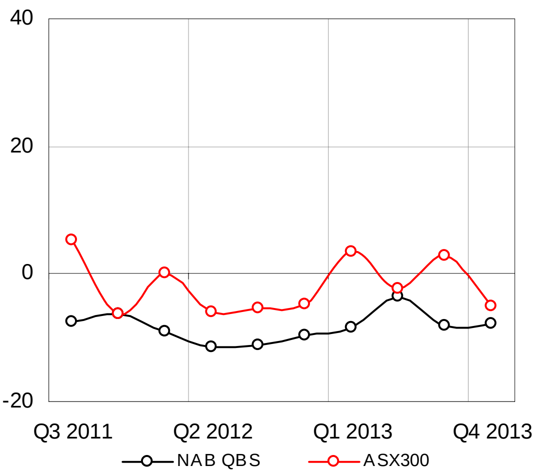


The gap in capacity utilisation between ASX 300 and the broader economy continued to narrow into the fourth quarter of 2013, with the ASX rate decreasing even further to 83% in Q4 (84% previously); in the wider economy, there was a slight increase to 81% in Q4 (80% in the Q3).

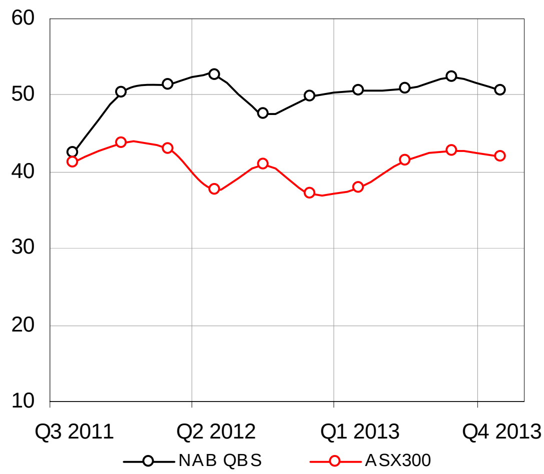
Recent data for both surveys show a modest up-tick in capital expenditure (capex), with QBS rising to +13 points – the highest level in two years. ASX 300 reported +6 points, its best result since Q4 2012. Short term expectations for capital expenditure are somewhat mixed, with firms in the QBS expecting more moderate improvements in capex. Near and longer term capex expectations for ASX 300 firms both picked up in the quarter.

Borrowing conditions dampened; Borrowing requirements up marginally

Ease of obtaining borrowings (net balance, nsa)



No borrowings required (%, nsa)



Recent data indicates that borrowing conditions overall remain subdued for both larger firms and businesses in the broader economy. Credit became more difficult to secure for larger firms, with the borrowing conditions index falling to -5 points, bringing it back into line with the QBS.

As anticipated in the September survey, fewer firms reported that they had no borrowing requirements in Q4, decreasing to 42% for ASX 300 and 51% for QBS – implying an increase in demand that may have contributed to the deterioration in borrowing conditions. This downward trend is expected to continue into the next quarter for the broader economy, but is expected to increase slightly for larger firms in the short term.

Industry analysis

Business conditions: Retail, Transport & Wholesale recorded the strongest improvements. Most other industries improved; but REC declined.

Most industries recorded improvements in business conditions in Q4, **retail** being the highlight – increasing to +38 points (up from -3 in Q3 2013).

Transport, utilities & communications (TUC) remains volatile, but improved strongly – jumping up to +33 points in Q4 for larger firms (from 0 previously) and to -8 points for the broader economy (from -15 points in Q3).

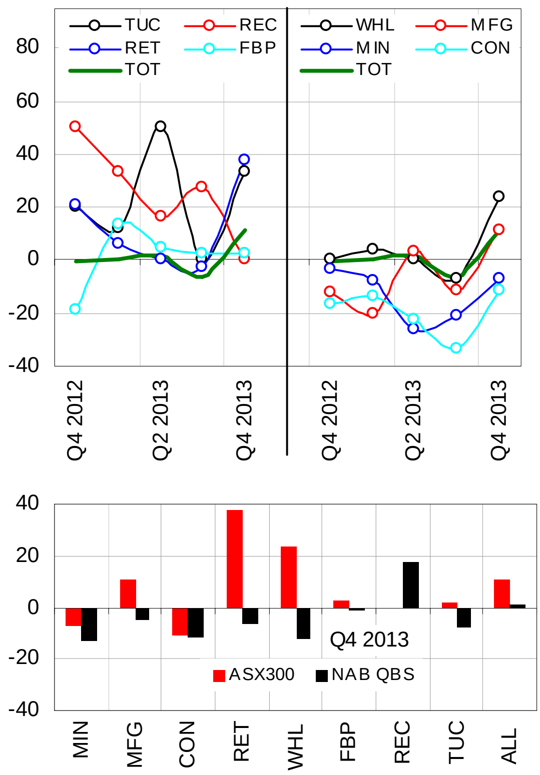
Third in was **wholesale** (WHL), increasing sharply for ASX 300 to +24 points (up from -7 in Q3); and to a lesser extent for the broader economy (up from -12 in December quarter from -19 points in Q3).

Recent data suggests a boost in **manufacturing** conditions, rising to +11 points (from -11 in the previous quarter), with near-term expectations for conditions also picking up.

Conditions in **construction** also improved to -11 points (from -33 points in Q3), however short-term expectations are soft and weakened further in the quarter.

In contrast to the previous survey where **recreational & personal Services** (REC) was the strongest performer for the larger firms, REC declined by a staggering 28 points in the fourth quarter to a zero reading. In contrast, the broader economy experienced a modest improvement in REC, increasing to +18 points in the December quarter (up from +13 points in Q3).

Business conditions (net balance, nsa)



Business confidence: Mining and Wholesale – main contributors to weakened confidence

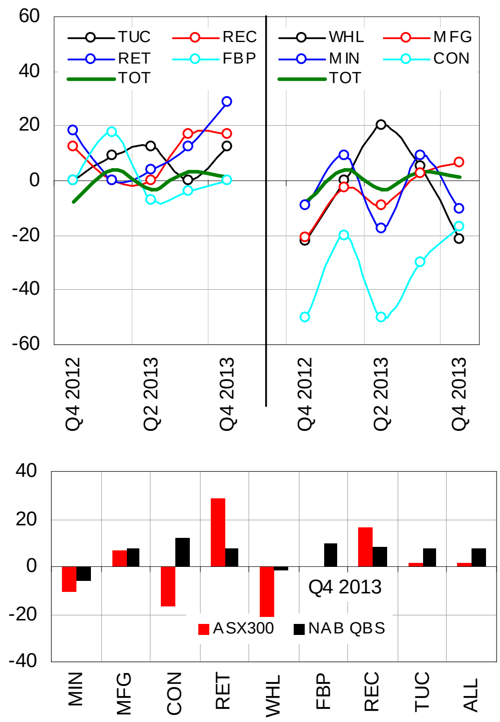
Sharp falls in confidence among **mining** (MIN) and **wholesale** (WHL) and a flat result in recreation and personal services were the main contributors to weaker business confidence amongst ASX firms.

Thus, for ASX 300, **mining** (MIN) confidence fell 20 points to relatively weak reading of -11 points for the quarter. **Wholesale** (WHL) declined by 26 points to an even weaker reading of -21 points during the same period.

On a brighter note, there was a slight improvement in **construction**, up to -17 points (from -30 points in the previous quarter), suggesting that the industry is still expected to deteriorate, but by a lesser degree than three months ago.

By comparison, business confidence in the broader economy remained flat, with slight improvement in **mining** and **construction** – both up to -6 points and +12 points. Confidence also improved for **manufacturing**, up to +8 points in the fourth quarter.

Business confidence (net balance, nsa)



Forward orders: expansion for construction and wholesale, with a slight improvement in finance, business & property services

Forward orders for larger firms continued to expand into Q4, predominantly driven by the upward trend in **construction** (up to +33 points from -40 points) and the bounce back in **wholesale** (up to +14 points from -10 points in Q3).

These trends are expected to flow through to improved conditions in the next quarter.

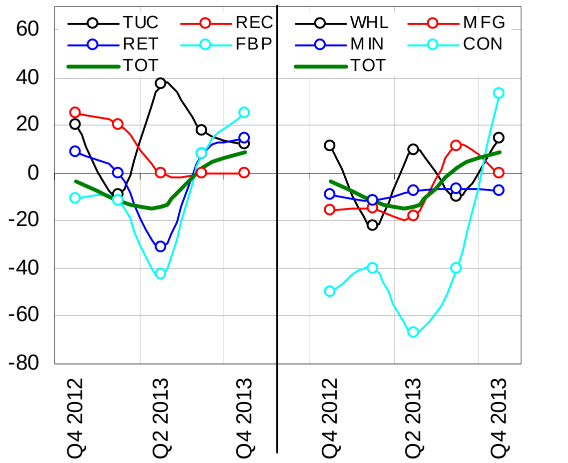
Finance, business & property services continued to strengthen; **retail** contributing to a lesser extent. Compared to the September survey, orders weakened for larger firms in **mining** and **manufacturing**.

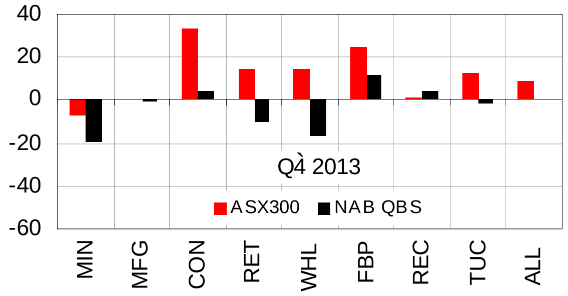
Orders remained subdued for **REC, COM, and electricity, water & gas.**

Contrary to the ASX 300, QBS reported an improvement in forward orders in a number of industries, despite the slight deterioration in **wholesale, retail** and **transport services.**

Overall, no significant changes are expected in the near term.

Forward orders (net balance, nsa)





Capital expenditure: Turns positive for the first time in a year

Larger firms experienced the highest level of **capital expenditure** in the December quarter since this time last year.

After being in the negative for the first three quarters of 2013, **capex** for larger firms edged up to +6 points increasing in tandem with the broader economy - also up to +13 points in Q4 2013.

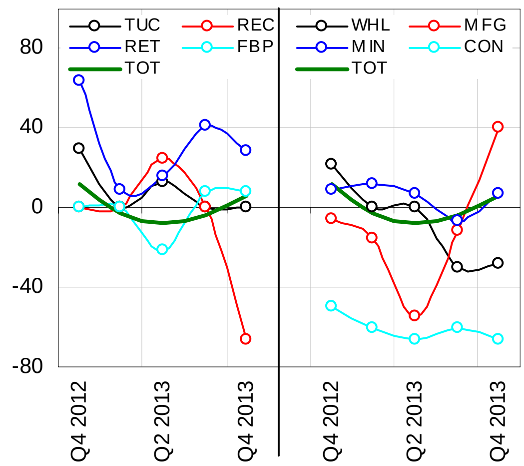
At its highest rate since the second quarter of 2011, **manufacturing** contributed to the improvement in **capex** (up to +40 points in the December quarter from -11 points). **Electricity, water & gas** increased modestly (up to +25 points from 0 points previously).

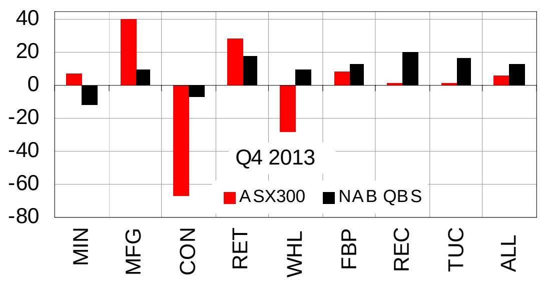
In contrast to the overall expansion, **REC** worsened sharply.

In line with the broader economy, QBS also reported an improvement in **capex**, with all industries surveyed gaining momentum - **transport services, manufacturing & wholesale** yielding the best improvement in the index. The capex index is now highest for recreation and personal services

The expansion is expected to continue into the near term for both the broader economy and larger firms; the capex index (for the next three months) rose in both surveys, although the increase was larger for ASX 300. In the near term, expected capex is expected to be weak for construction, wholesale and personal & recreational services, although expectations for construction actually improved from the previous quarter.

Capital expenditure (net balance, nsa)





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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