more give, less take

NAB Quarterly Business Survey

by NAB Group Economics

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September Quarter 2014

National Australia Bank

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Key Points:

- Business confidence was unchanged in Q3, remaining close to the long run average levels. However, our monthly survey shows that the momentum has turned, with confidence easing steadily over the quarter. Similarly, conditions were up marginally in the quarter due to a surprisingly strong July result, but eased over the following two months. There was a slight lift in 12 month expectations.
- Sentiment was mixed across the states and industries, but we continue to see interest rate sensitive sectors, particularly construction, performing well due to low interest rates and strong investor demand (including foreign investors). Service industries remain relatively positive as well.
- The recent large depreciation in the AUD occurred after the survey period, so is not reflected in firms' responses to questions on AUD impacts. When responding, import competing and trade exposed sectors still considered the currency to be at unfavourable levels. Mining and retail reported the largest deterioration, although these firms are also among the most uncertain over what strategies to use to mitigate currency risks. (See our special survey question.)
- Outside of the services and construction sector, business conditions remain soft in levels terms. Recreation & personal services and finance/ property/ business services report the most positive business conditions, while mining continues to be very weak.
- Forward orders eased, suggesting sluggish domestic demand to continue in the near term. This is consistent with average rates of capacity utilisation, but suggests a lack of urgency for firms to invest – much stronger non-mining investment will be needed to achieve trend growth in domestic demand. Nevertheless, business investment intentions (next 12 months) rose slightly in the September quarter to be at above average levels. The most recent ABS Capital Expenditure Survey also suggests an increase in non-mining investment, but not enough to offset the coming 'cliff' in mining investment.
- Product price inflation remained subdued in the quarter - an annualised rate of 0.6% (0.2% in the quarter), reflecting softer purchase cost growth and subdued (albeit slightly higher) growth in labour costs. Retail prices lifted modestly.

Table 1: Key quarterly business statistics*

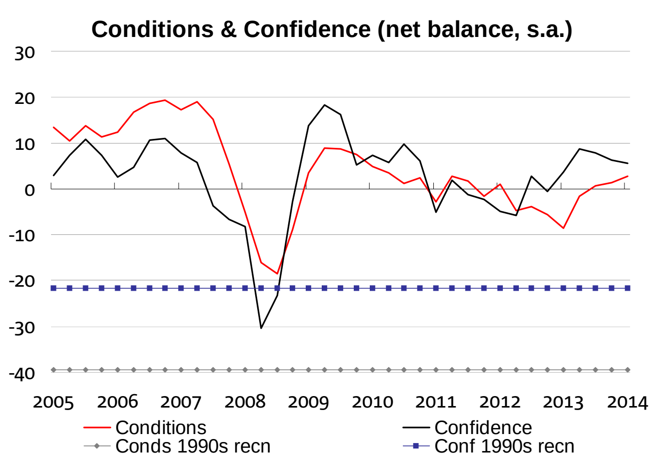
	2014q1	2014q2	**2014q3**		2014q1	2014q2	**2014q3**
		Net balance				*Net balance*	
Business confidence	8	6	**6**	Trading	6	4	**7**
Business conditions				Profitability	1	0	**2**
Current	1	1	**3**	Employment	-5	-1	**0**
Next 3 months	12	12	**11**	Forward orders	3	2	**1**
Next 12 months	24	24	**25**	Stocks	0	2	**2**
Capex plans (next 12)	18	21	**22**	Exports	1	2	**1**
% change							
Labour costs	0.4	0.4	**0.5**	Retail prices	0.3	0.0	**0.2**
Purchase costs	0.5	0.3	**0.2**				
Final products prices	0.2	0.2	**0.2**	Capacity utilisation rate	80.1	80.3	**80.6**

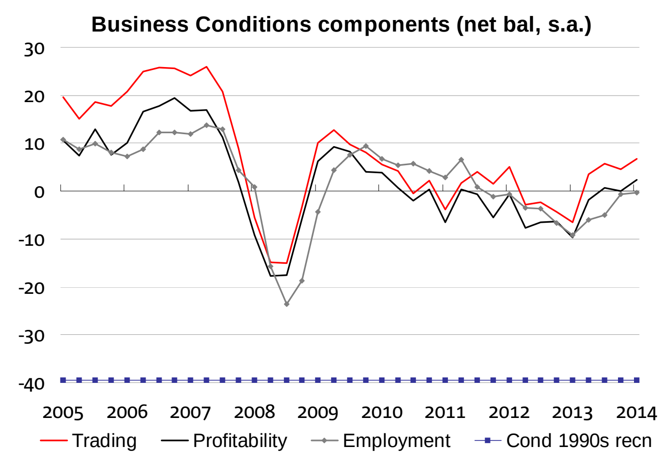
** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 25 August to 10 September 2014, covering over 900 firms across the non-farm business sector.

Contents

Analysis

- There was a slight improvement in business conditions in the September quarter (up 2 to +3 index points), with the index moving above the long-run average (+1) – suggesting domestic demand growth was closer to trend. However, the monthly survey showed that much of the improvement came from a surprising, and narrowly based, jump in conditions during July. Conditions steadily eased over the remainder of the quarter. Consistent with this, forward orders eased, indicating limited momentum for domestic demand in the near term. The improvement was driven by better trading and profitability, while employment was unchanged at soft levels. In contrast, firms' confidence was unchanged (+6) at around (or slightly above) long run average levels (+5). That said the monthly index shows that confidence eroded over the course of the quarter.
- Given the persistent uncertainty facing firms, stemming from factors both domestic and abroad, any expectation for a significant rebound in domestic demand would seem premature. Both consumers and business remain cautious about spending, despite encouragement from very low interest rates, which is unsurprising given slower rates of income growth. Consequently, corporate leverage ratios are low and household savings rates remain high, although there have been signs of improvement more recently. On a more positive note, recent falls in the AUD will help Australian export competitiveness, although with the drawback of higher cost pressures, while residential construction remains a relative bright spot that should have flow on effects to the rest of the economy.

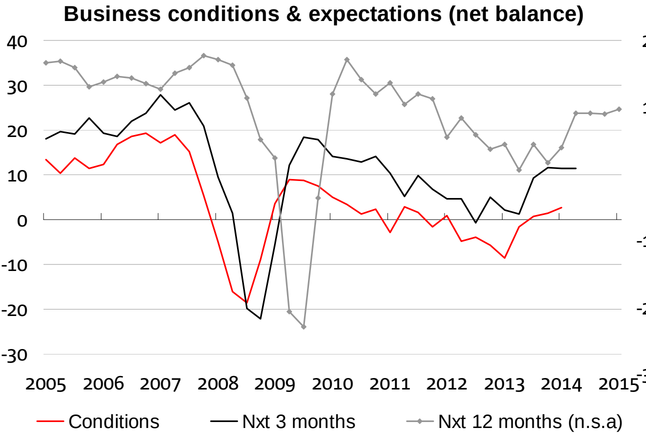




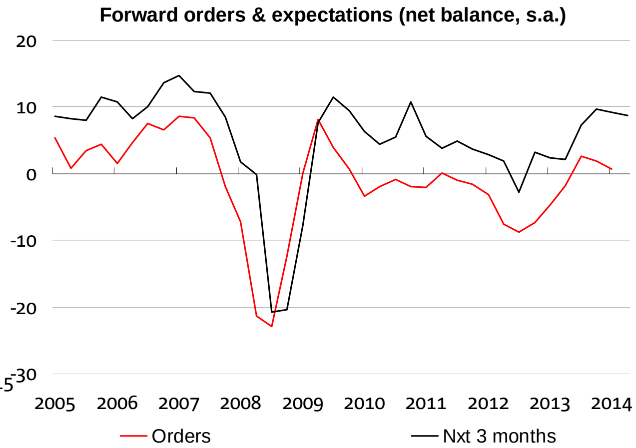
Forward indicators

- Despite an improvement in business conditions in recent quarters, the positive momentum in firms' expectations for activity in their own business has subsided a little – three and twelve month expectations have flattened out. This is consistent with easing confidence levels since the start of the year. Similarly, forward orders eased to +1 index points, implying only a moderate improvement in near-term demand. Near-term expectations for orders (next 3-months) are more positive, but the index is lower than in the June quarter.
- Stocks can also be an indicator of near-term activity. Although trading conditions are more positive, the relatively moderate orders index may be preventing firms from re-stocking more aggressively given limited prospects for stronger demand. However, expectations for stocks (3 months ahead) are no longer negative, although they remain soft, having steadily improved over the past 18 months.

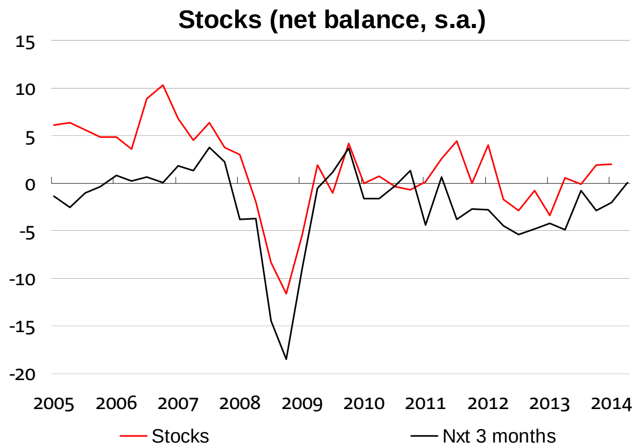
Expectations for 'own business' conditions are flattening



Orders recovery stalls, but at reasonable levels



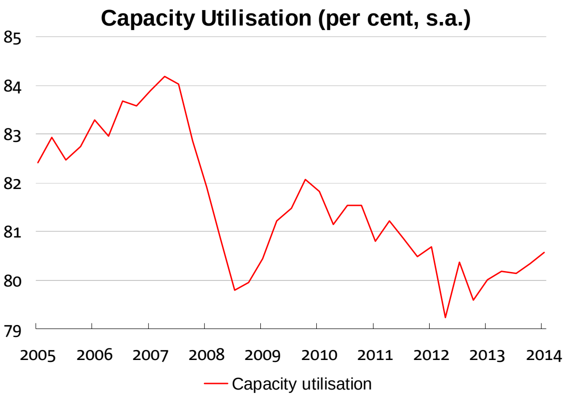
Solid trading conditions encouraging some re-stocking



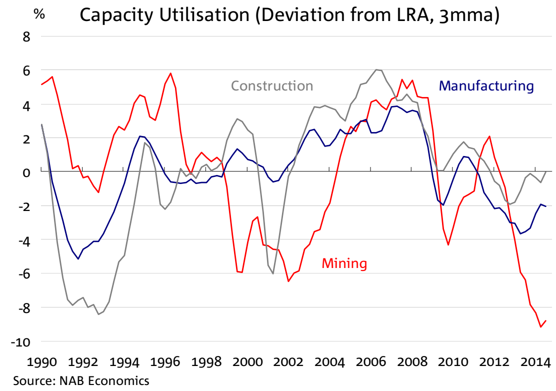
Forward indicators (cont.)

- Capacity utilisation has been tracking steadily higher, rising 0.3 ppts to 80.6%. This is consistent with the long-run average and is a welcome sign that the economy is gradually working through the excess capacity that has constrained non-mining business investment for a number of years. However, this level is still below the monthly survey average of around 81% (from 1997). The surge in building approvals over the past year is keeping construction utilisation rates elevated (82.7%), while utilisation in personal and professional services are elevated too. All other industries, have utilisation rates that are below long run averages.
- According to the NAB survey measure of business capital expenditure, business investment growth may lift notably in the next 12 months. However, caution should be used when interpreting capex data as mining investment is under represented in our survey, meaning the degree of offset coming from the mining sector may not be fully captured. Indeed, the current mining capex index is one of the worst performing among the major industries, at -1 point, although this is an improvement from recent quarters. On a positive note, 12 month ahead mining capex expectations have shown an improvement, although they remain soft relative to history (up 6 to +14 points). The retail capex index is next lowest, which is a reflection of high consumer anxiety that is contributing to soft business conditions (second worse behind mining). Other than retail and construction, capex is slightly positive across the rest of the non-resources sector.

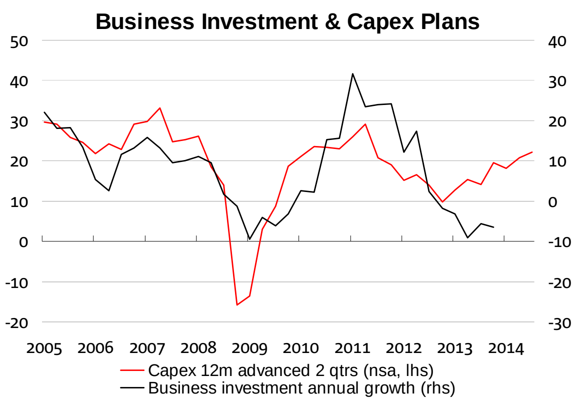
Capacity utilisation low, despite upward trend – limiting capex and inflation pressures



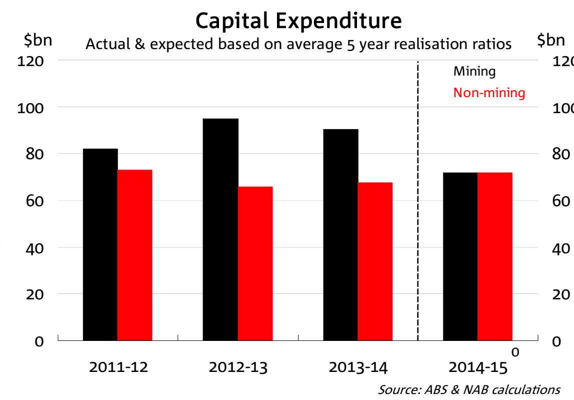
Spare mining capacity rising as investment boom ends



Capex intentions suggests a return of non-mining investment



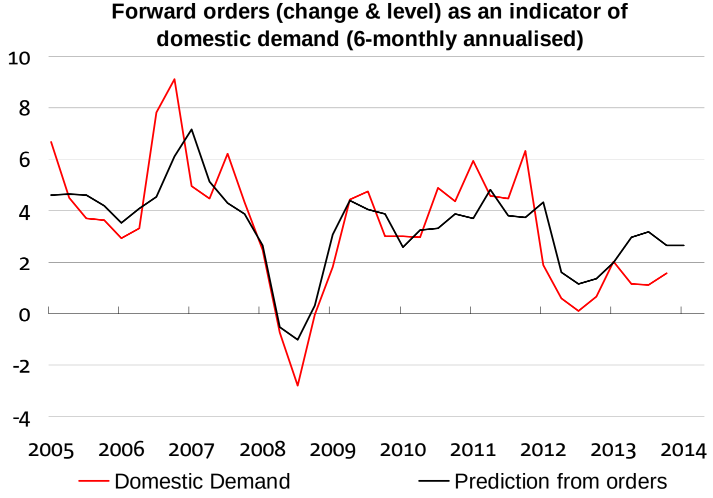
ABS survey showing only minimal non-mining investment growth



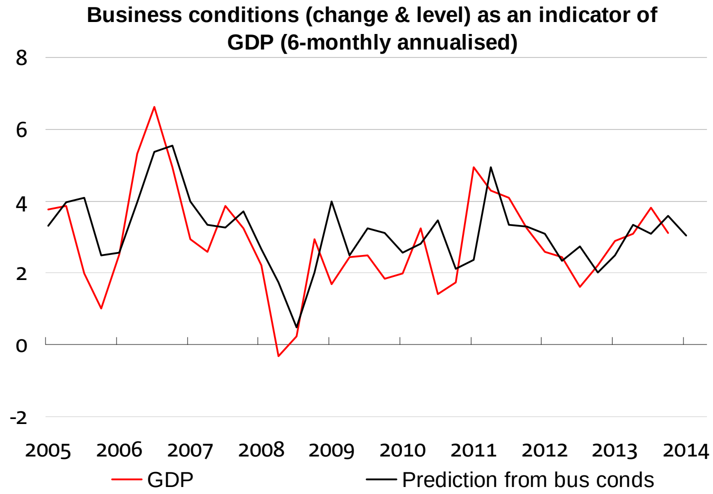
Implications for forecasts For more information see latest Global & Australian Forecasts

- Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has been suggesting stronger growth than the national accounts in recent quarters. Nevertheless, applying forward orders from the Q3 NAB Business Survey to our model (+1) suggests that predicted demand growth will hold steady at previous (subdued) levels.
- Similarly, business conditions over-predicted GDP growth in Q2. Based on business conditions from the September quarter survey, our model implies slightly softer predicted GDP growth in Q3.
- Looking at business conditions in bellwether industries such as wholesale and transport suggests that conditions could be slightly softer than these models suggest. Wholesale conditions are currently 0 points, while transport and utilities are only marginally positive (+1 points).

Orders point to stable domestic demand



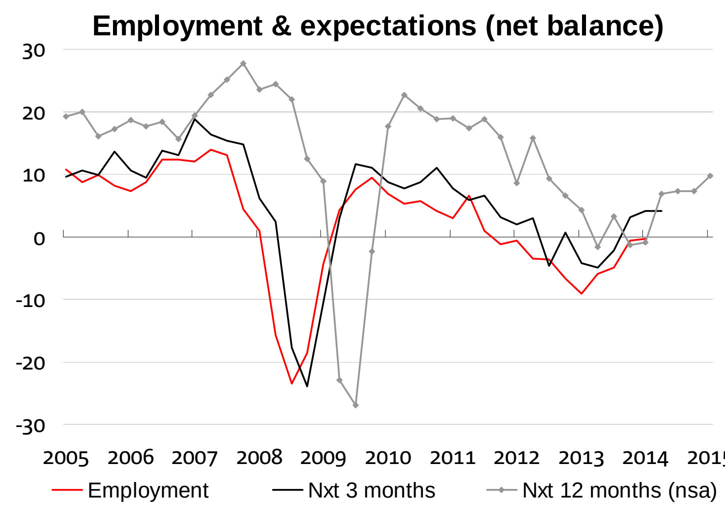
Conditions suggest slightly softer GDP



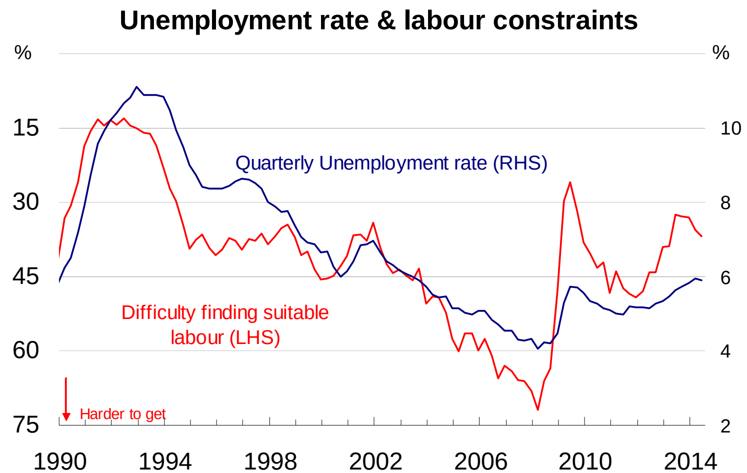
Labour Market

- The employment index lifted modestly in the September quarter (up 1 point to 0 index points), although this is still only suggesting relatively modest rates of employment growth. These levels are consistent with some additional slack in the labour market that will see the unemployment rate lift a little further from its current level, which was 6.1% in September. Average hours worked lifted only slightly to 39.9 hours (from 39.8 hours) in the September quarter.
- Near-term employment expectations remained positive (albeit still soft at +4 index points), but longer term expectations improved again. This is a positive outcome given that the labour market has so far lagged improvements in the other components of business conditions (trading and profitability). Official labour force data for September needs to be interpreted with caution due to statistical anomalies, but nonetheless showed a slight rise in the unemployment rate (from 6.0% in June to 6.1%), hitting its highest level in more than a decade.
- Firms continue to report relative ease finding suitable labour

Longer-term employment expectations better

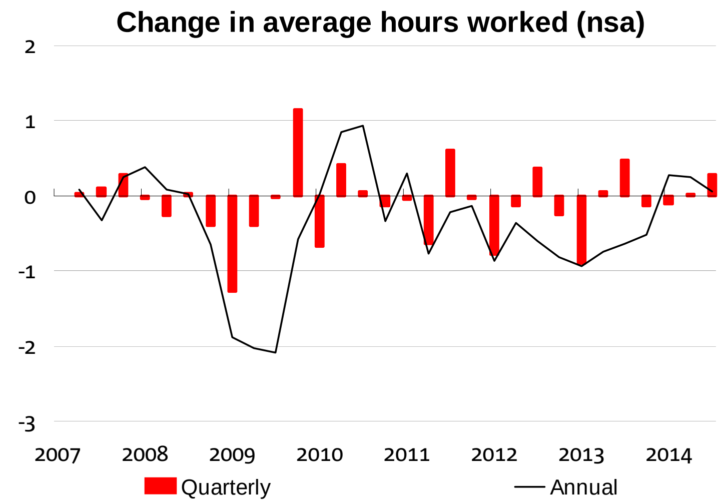


Labour still relatively easy to find



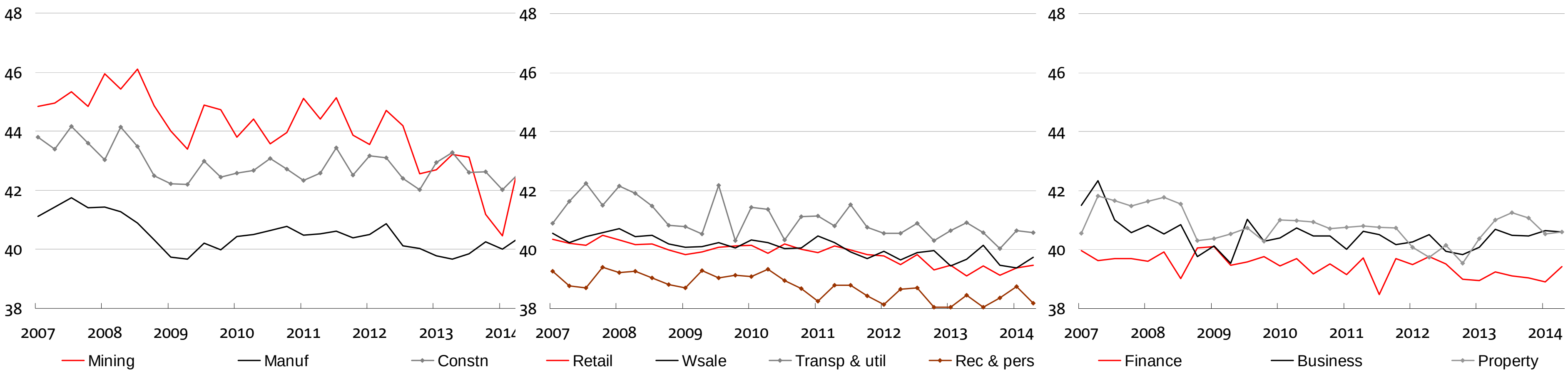
Sources: ABS; NAB

Average hours marginally higher



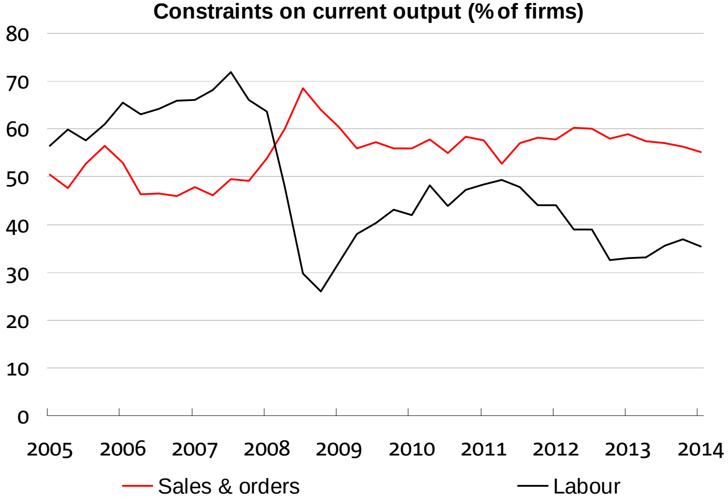
Labour Market (cont.)

Average weekly hours worked by industry (nsa)

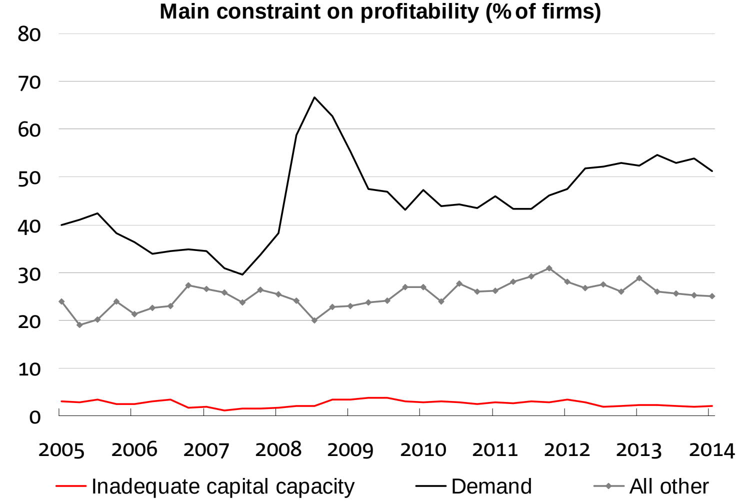


Major constraints on firm output & profits

Constraints on current output (% of firms)



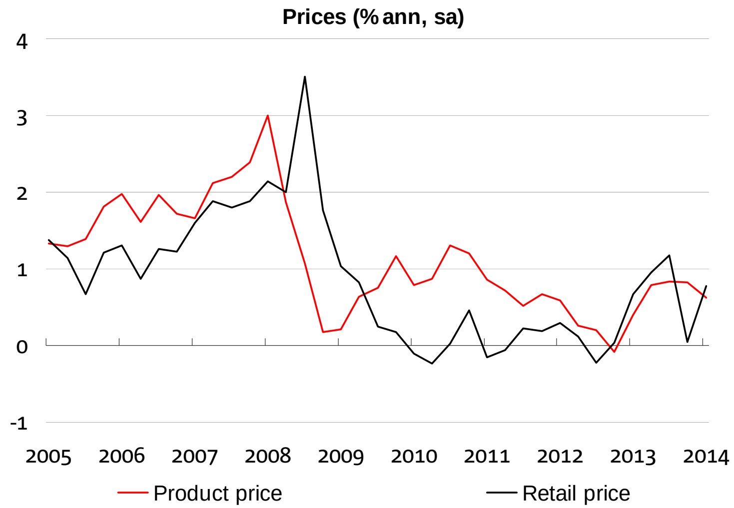
Main constraint on profitability (% of firms)



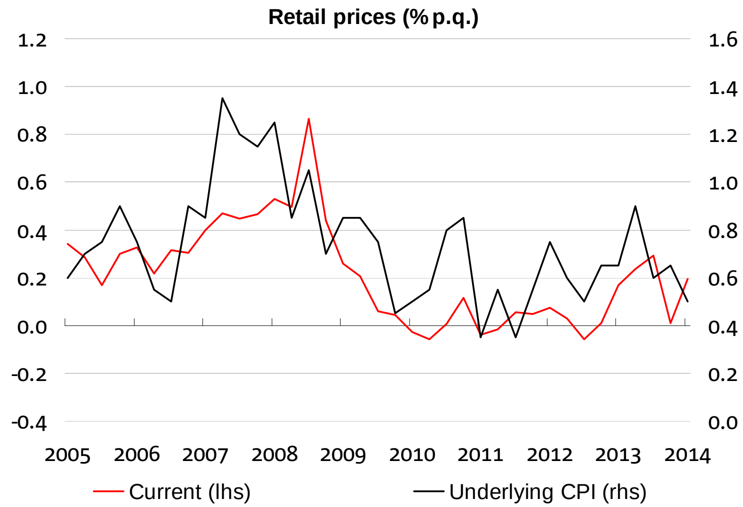
Inflation pressures

- Trading conditions are positive implying better demand, but the prevailing slack in the economy (evidenced by below average capacity utilisation in most industries) is helping to keep inflationary pressures well contained. Final product prices growth eased slightly to a modest 0.6% annualised (down from 0.8%). Higher labour cost inflation was offset by softer purchase cost inflation.
- Only retail price inflation increased in the quarter, while mining price deflation eased (from -0.9% to -0.6% at a quarterly rate) – consistent with easing commodity prices. Final product price inflation eased in wholesale, manufacturing and recreation & personal services (to 0.2%, 0.2% and 0.4% respectively, at a quarterly rate), while the remaining industries were unchanged. Quarterly prices growth was strongest in recreation & personal services (0.4% in the quarter).
- Labour and purchase costs have continued to outstrip growth in firm's final product prices, although the spread to purchase costs has narrowed – consistent with the survey's findings of some modest relief to profit margins. The spread with labour costs had also narrowed in previous quarters, but widened again in September as labour costs rose – a surprising result given existing slack in the labour market. Furthermore, with the AUD expected to continue on a downward track over 2015, importing firms are likely to experience renewed pressure from purchase costs. However, for now the removal of the carbon tax and lower energy costs are providing some relief for firms.

Price growth eases notably, consistent with softer core CPI



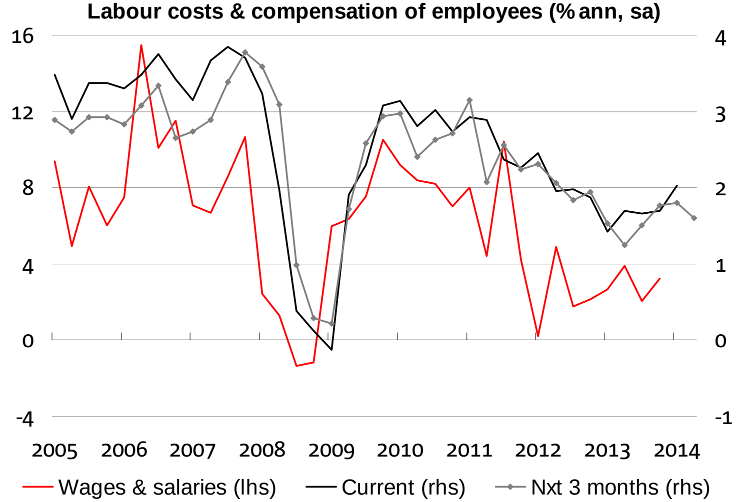
Retail price growth lifted, but still consistent with subdued core CPI



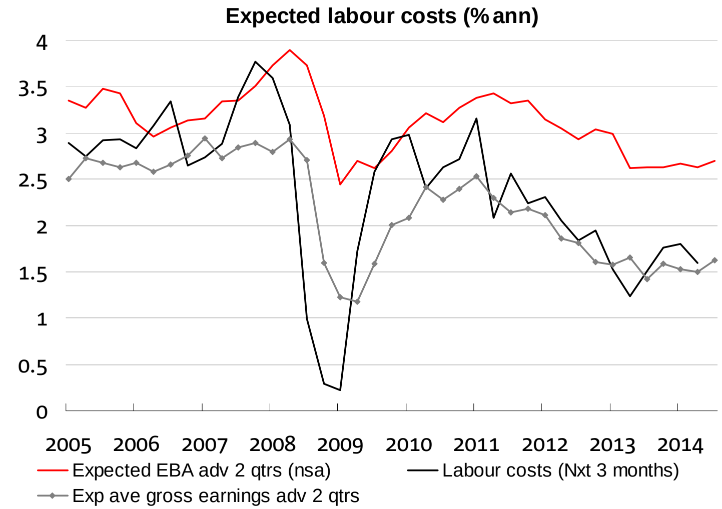
Labour costs (details) and market expectations

- Annualised labour costs growth picked up pace to 2.0% in the quarter, although this is still well below the series average of 3.0% since 1989. The subdued pace of growth is consistent with soft employment conditions, with the ABS labour force survey posting a rise in the unemployment rate to a decade high of 6.1%. However, other indicators of labour market conditions, such as job vacancies, although soft, are pointing to an improvement in labour demand. Wage pressures are likely to remain fairly benign, with wage increases under EBAs expected to average just 2.7% over the next year, or 1.6% after allowing for productivity offsets.
- On average, businesses maintained their expectation of a rise in short-term interest rates, slightly lower at 11 bps, which was consistent with economists' forecasts at the time for the next cash rate move to be up – the market is now pricing in a cut. Exchange rate expectations (6-months-ahead) remained elevated at US$0.92 in the quarter, from US$0.91, with firms apparently not anticipating the subsequent depreciation that followed the survey period – largely driven by USD strength.
- Medium-term inflation expectations remained soft, with 51% of respondents expecting inflation to remain below 3% (although down from previous quarter) and 41% expecting inflation of 3-4% (was 36%). Only 2% of firms believe inflation is a serious problem (unchanged), while 28% believe it is a minor problem (26% previously).

Soft labour market restrain labour cost pressures



Labour cost expectations stable

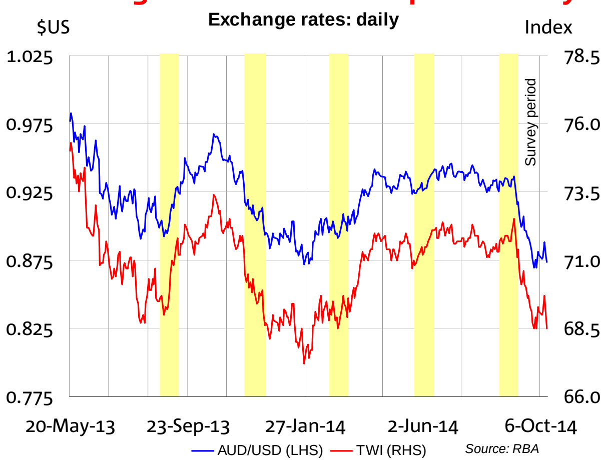


	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.3	2.7	3.0	2.6	2.2	2.7	2.7	2.7	2.7
Productivity offset	1.1	1.1	1.7	1.3	2.0	1.6	0.6	1.0	1.1
Net EBA growth	0.2	1.6	1.3	1.3	0.2	1.1	2.1	1.8	1.6

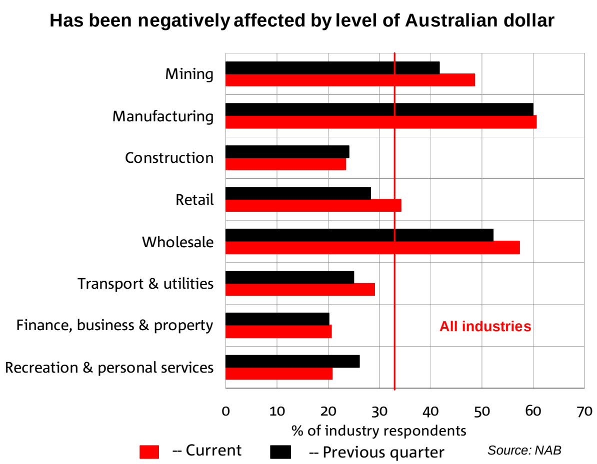
Business & the AUD

- In NAB's Quarterly Business Survey, we have asked businesses how they have been affected by the level of the Australian dollar, and what strategies they have been using to mitigate the negative impacts. The interviews for this question were conducted between 25 August and 10 September, when the exchange rate averaged $US 0.93 and 71.8 on a TWI basis. These levels are similar to the June survey period, but well above current rates (around $US 0.87).
- According to the survey, a third of non-farm businesses reported an adverse impact from the AUD (slightly higher than Q2 2014), which is unsurprising given the relative stability of the AUD since the last survey. Most industries recorded more negative impacts from the AUD in the quarter – the biggest changes occurring in mining and retail – largely offset by an improvement in recreation & personal services and construction. Larger deterioration in mining and retail is not too surprising given the relatively high share of firms in these industries that are unsure of what strategies to use to manage currency risk (although they are not the only industries in that position – see chart below). Manufacturing, followed by wholesale, are still most negatively affected by the AUD, while Fin/ bus/ prop and rec/personal services appear to be most insulated from the AUD, reflecting less import competition and few foreign input costs. While the mining sector reported a higher proportion that are feeling adverse effects from the AUD, recent depreciations will come as a welcome development. Commodities tend to be bought and sold in USD, limiting the direct impact AUD has on volumes, but a falling AUD will support mining profitability by lowering costs of Australian operations.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy used by affected firms, especially in wholesale and manufacturing, although the strategies employed by these industries are quite diverse. Downsizing remains a more important strategy in manufacturing, mining and construction than any other industry. Unsurprisingly, the industries reporting the least adverse impacts from the AUD are also less active in managing currency risks.

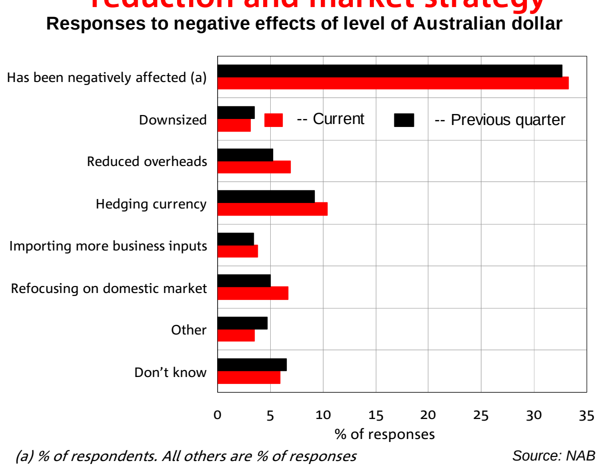
Exchange rate weakened post survey



Most industries more affected



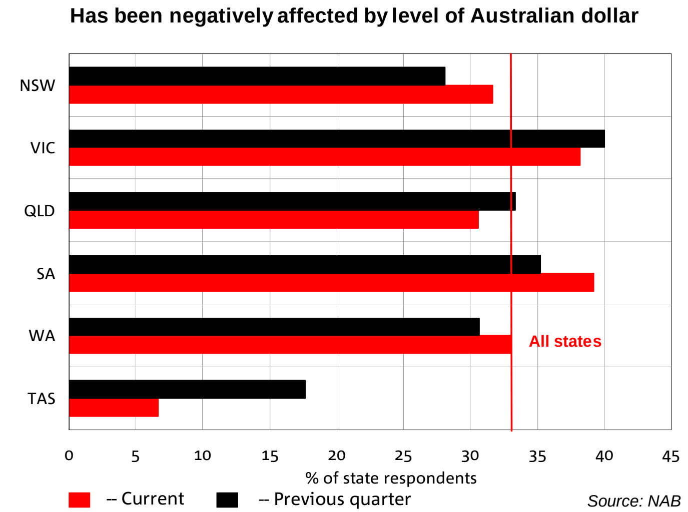
More firms focus on hedging, cost reduction and market strategy



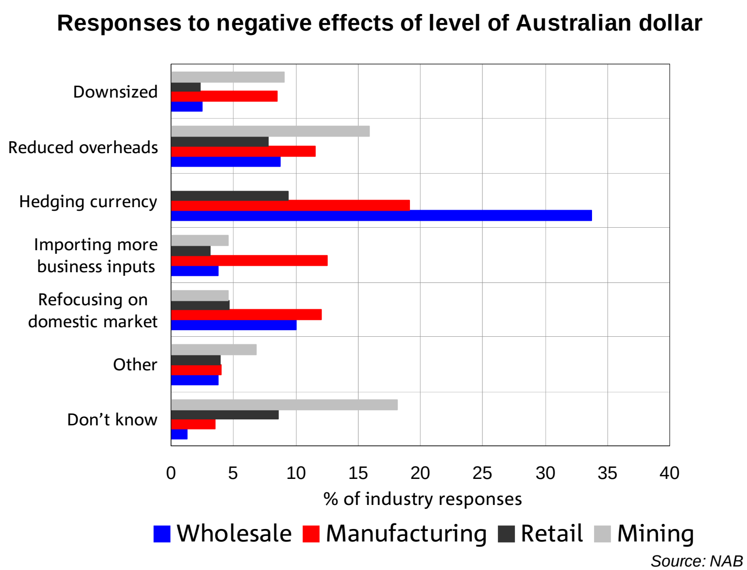
Business & the AUD (cont.)

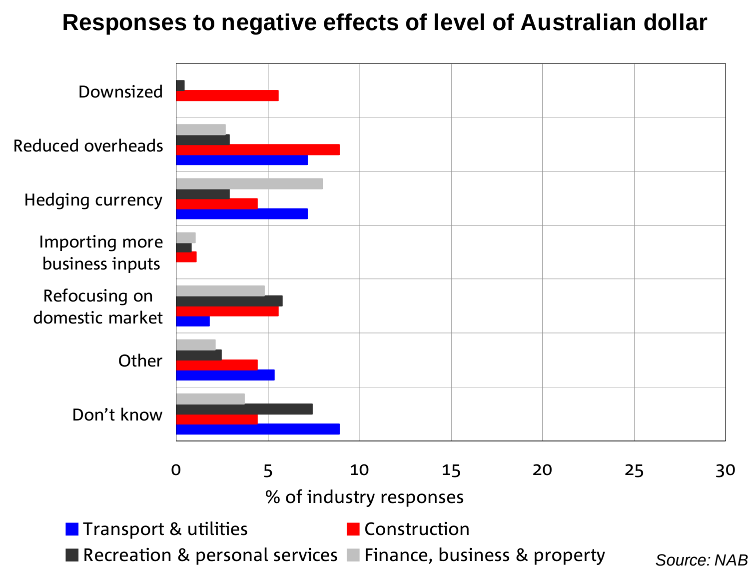
- Negative exchange rate effects increased and were also most prevalent in South Australia, following some pull back in Victoria. Nevertheless, both these states continue to show the most negative response to the AUD, probably reflecting the relative importance of manufacturing. But by the same token, the notable improvement in Tasmania from the previous survey was surprising given that the level of the AUD is likely affecting the competitiveness of that state's industries (also highly concentrated in manufacturing) – although the sample of firms for the state can contribute to volatility. The deterioration in WA is consistent with what was reported by the mining industry, although in Queensland – the other big mining state – responses actually improved in the quarter.
- Hedging was important for wholesalers and manufacturers; downsizing and cost reduction were most prevalent in mining and manufacturing.

Impact of $A mixed across states



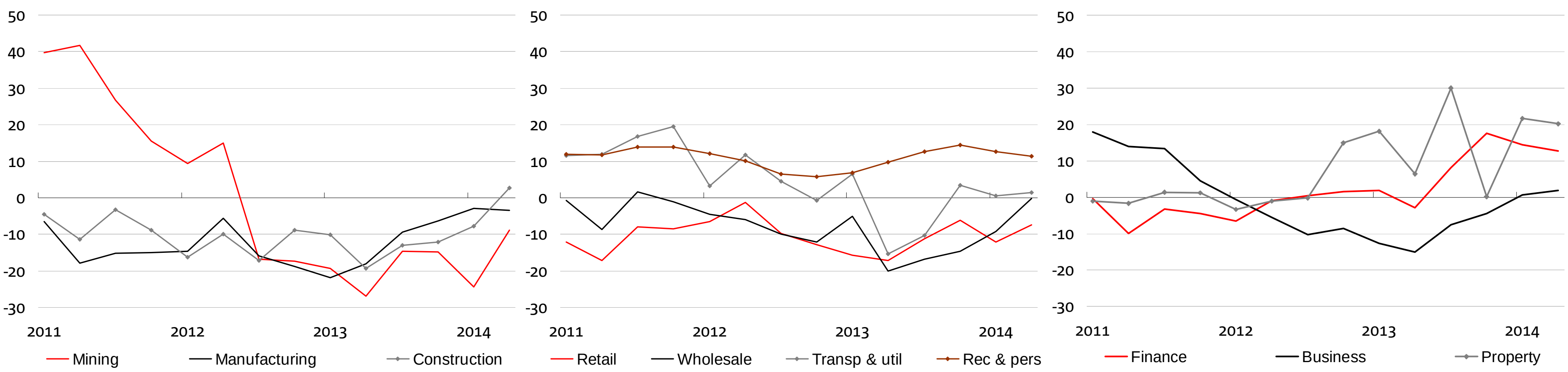
Hedging preferred in wholesale and manufacturing



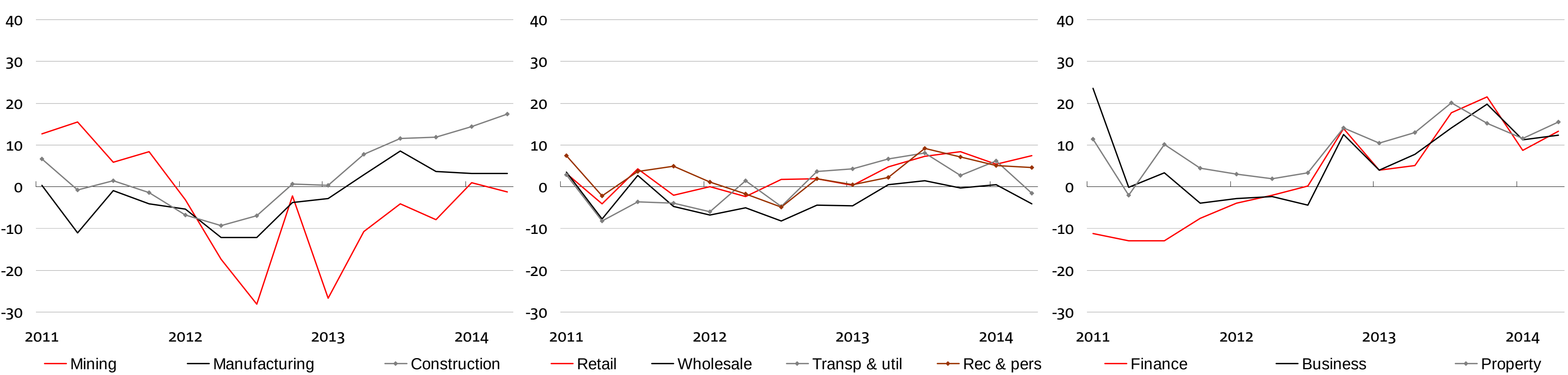


More details on industries

Business conditions by industry (net balance)

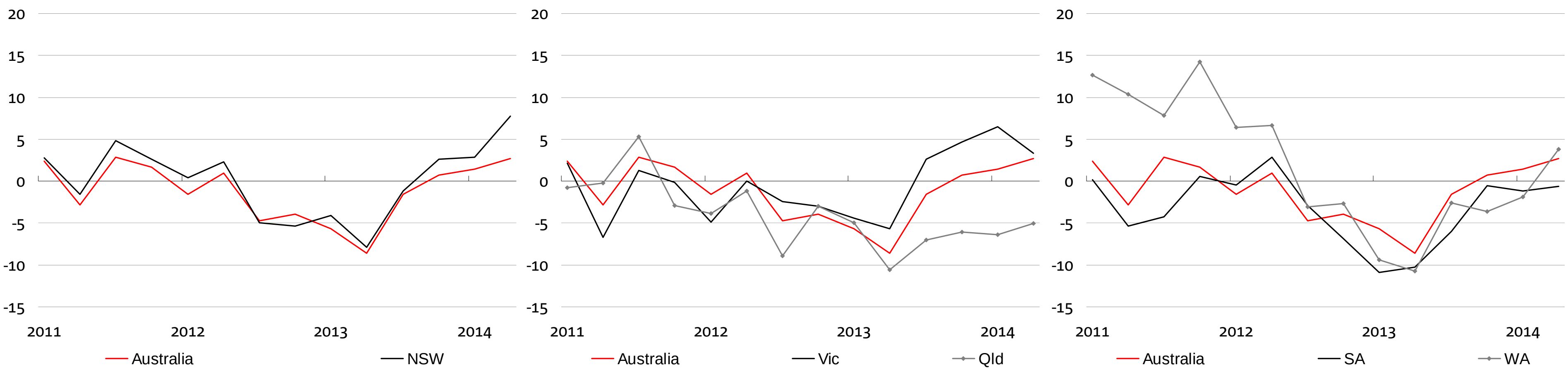


Business confidence by industry (net balance)



More details on states

Business conditions by state (net balance)



Business confidence by state (net balance)

Data appendix

	Quarterly					*Monthly*				
	2013q3	2013q4	2014q1	2014q2	**2014q3**	2014m5	2014m6	2014m7	2014m08	2014m09
Confidence	4	9	8	6	**6**	8	8	9	7	5
Conditions	-9	-2	1	1	**3**	0	2	8	3	1

	Quarterly					*Monthly*				
	2013q3	2013q4	2014q1	2014q2	**2014q3**	2014m5	2014m6	2014m7	2014m08	2014m09
Trading	-6	3	6	4	**7**	2	7	12	6	6
Profitability	-10	-2	1	0	**2**	-2	3	9	3	0
Employment	-9	-6	-5	-1	**0**	0	-3	0	-1	-4

	Quarterly [(a)]					*Monthly*				
	2014q2	2014q3	2014q4	2015q2	2015q3	2014m5	2014m6	2014m7	2014m08	2014m09
Conditions	1	**3**				0	2	8	3	1
Conds. next 3m	12	12	**11**							
Conds. nxt 12m	13	16	24	24	**25**					
Orders	2	**1**				0	0	5	0	-1
Orders next 3m	10	9	**9**							

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

	Quarterly [(a)]					*Monthly*				
	2013q4	2014q1	2014q2	2014q3	**2014q4**	2014m5	2014m6	2014m7	2014m08	2014m09
Capacity utilis.	80.2	80.1	80.3	**80.6**	NA	80.3	79.1	81.0	80.6	80.2
Stocks current	1	0	2	**2**	NA	1	3	2	1	-2
Stocks next 3m	-5	-1	-3	-2	**0**					

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

Constraints on output (% of firms)*	2013q3	2014q2	2014q3
Sales & orders	57.1	56.3	**55.1**
Labour	35.5	36.9	**35.3**
Premises & plant	19.7	21.5	**18.2**
Materials	8.9	9.4	**8.7**

** not s.a.*

Main constraints on profitability (% of firms)*	2013q3	2014q2	2014q3
Interest rates	2.5	1.7	**2.3**
Wage costs	12.3	13.4	**14.6**
Labour	4.5	3.9	**4.8**
Capital	2.2	2.0	**2.1**
Demand	53.0	53.9	**51.3**
All other	25.6	25.1	**25.0**

Data appendix (cont.)

	Quarterly [a]					Monthly				
	2014q2	2014q3	2014q4	2015q2	2015q3	2014m5	2014m6	2014m7	2014m08	2014m09
Empl current	-1	**0**				0	-3	0	-1	-4
Empl next 3m	3	4	**4**							
Empl nxt 12m	-1	-1	7	7	**10**					

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

	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.3	2.7	3.0	2.6	2.2	2.7	2.7	2.7	2.7
Productivity offset	1.1	1.1	1.7	1.3	2.0	1.6	0.6	1.0	1.1
Net EBA growth	0.2	1.6	1.3	1.3	0.2	1.1	2.1	1.8	1.6

State Tables

	Quarterly					Monthly				
	2013q3	2013q4	2014q1	2014q2	2014q3	2014m5	2014m6	2014m7	2014m08	2014m09
Business conditions										
NSW	-8	-1	3	3	**8**	2	3	11	8	1
VIC	-6	3	5	6	**3**	3	5	2	2	12
QLD	-11	-7	-6	-6	**-5**	-9	-4	6	-4	-6
SA	-10	-6	-1	-1	**-1**	-3	3	12	-5	5
WA	-11	-3	-4	-2	**4**	0	9	8	11	1

	Quarterly					Monthly				
	2013q3	2013q4	2014q1	2014q2	2014q3	2014m5	2014m6	2014m7	2014m08	2014m09
Business confidence										
NSW	2	6	7	6	**4**	8	7	10	7	3
VIC	3	6	5	5	**7**	7	8	9	6	7
QLD	7	14	10	9	**11**	8	13	12	13	2
SA	11	15	9	7	**3**	7	7	7	3	1
WA	3	7	8	4	**1**	6	0	13	2	-5

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