NAB Quarterly Business Survey

by NAB Group Economics

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June Quarter 2015

National Australia Bank

For more information contact: Alan Oster, Chief Economist: (03) 8634 2927 or 0414 444 652 or Riki Polygenis, Head of Australian Economics: (03) 8697 9534
Alt. James Glenn, Senior Economist: (03) 9208 8129

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Key Points:

- The June quarter NAB Business Survey confirms the trend of gradually improving near-term indicators, but with a somewhat patchy longer term outlook. Business confidence strengthened in Q2 to +4 index points (from 0 points), which is its highest level since Q3 2014 and consistent with the long-run average for the series. Conditions were also marginally better in Q2, up 1 to +4 index points, which is above the long-run average level. Despite the improvement, both confidence and conditions in the monthly survey finished the quarter significantly higher (+10 and +11 point respectively). Encouragingly, firms expectations for future activity improved as well.
- While Australia continues to face a 'patchwork' economy, the Q2 Survey finally gave some indication that positive momentum is broadening across sectors. In particular, confidence is now positive for all industries outside of the mining sector. This is not the case for conditions, although fewer industries had negative conditions in Q2 than last quarter. Service sectors continue to outperform by a large margin in terms of conditions, but confidence is more varied. Responses from mining firms continue to be affected by lower commodity prices and falling investment, while industries sensitive to interest rates and AUD look to be doing better. Retail may also have been buoyed by the Governments small business incentives in the Budget.
- Leading indicators from the survey remain patchy. Forward orders were down slightly and are at subdued levels. Firms' expectations for conditions in 3 and 12 months time both improved, as did conditions in the 'bellwether' wholesale industry – although the level remains very weak. Perhaps most concerning is that capacity utilisation was unchanged and capex plans for the next 12 months eased back (albeit still elevated). The ABS Capital Expenditure Survey, however, suggests a much weaker outcome for non-mining investment.
- Product price inflation was relatively subdued at an annualised rate of 0.9% (0.2% in the quarter), reflecting both modest labour cost growth and softer purchase cost inflation. In contrast, retail prices accelerated (in contrast with lower official underlying inflation in Q2).
- Despite some volatility, the AUD during the Q2 survey period was broadly similar to what it was last quarter. Unsurprisingly then, the proportion of firms reporting adverse effects from the currency was barely changed. Looking over a longer period (12 months), most industries appear to have seen a benefit from AUD depreciation. Retail, transport & utilities and wholesale are the exceptions, possibly reflecting higher import costs. Firms also showed more preference towards employing more defence measures to manage currency risk.

Table 1: Key quarterly business statistics*

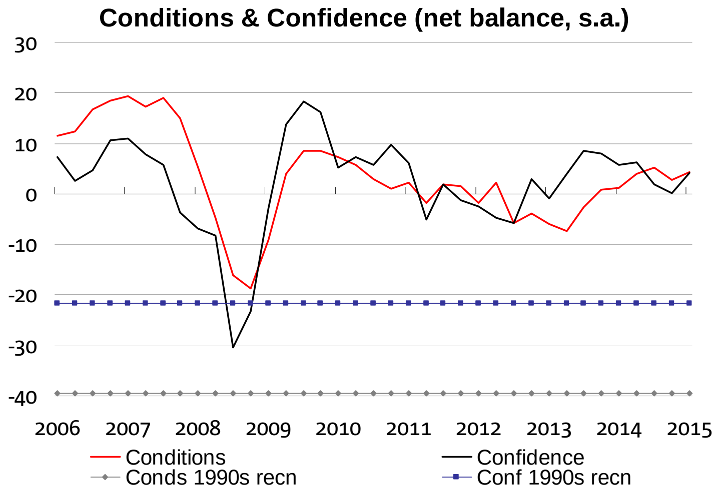
	2014q4	2015q1	**2015q2**		2014q4	2015q1	**2015q2**
		Net balance				*Net balance*	
Business confidence	2	0	**4**	Trading	10	7	**11**
Business conditions				Profitability	6	1	**4**
Current	5	3	**4**	Employment	0	0	**-1**
Next 3 months	9	8	**10**	Forward orders	2	2	**1**
Next 12 months	22	18	**19**	Stocks	1	1	**0**
Capex plans (next 12)	21	21	**18**	Exports	1	1	**1**
% change							
Labour costs	0.4	0.3	**0.4**	Retail prices	0.2	0.3	**0.7**
Purchase costs	0.5	0.5	**0.4**				
Final products prices	0.2	0.2	**0.2**	Capacity utilisation rate	80.4	80.9	**80.9**

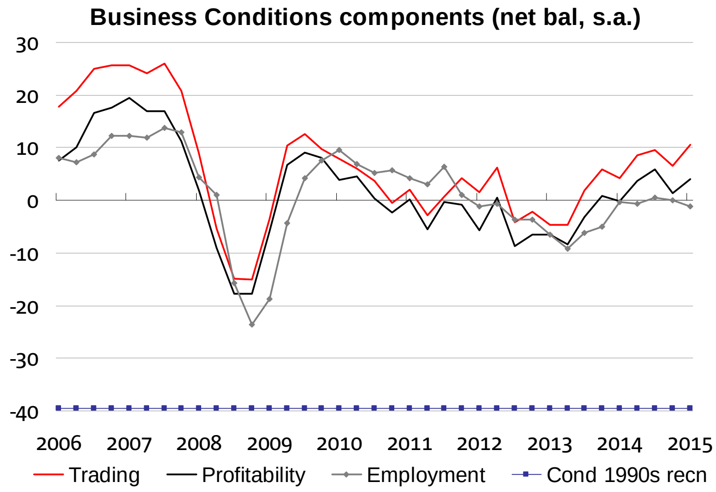
** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 25 May to 11 June 2015, covering over 900 firms across the non-farm business sector.

Contents

Analysis

- Business **conditions** were up marginally in the June quarter, rising to +4 points (from +3), while the more timely monthly survey showed much more significant improvement in the business environment over the course of the quarter. This outcome for the quarter is above the long-run average of +1 index point, suggesting that domestic demand growth in Q2 may have been closer to trend (see p6). By component, trading and profitability were both higher (the former at its highest level since 2009), while employment softened further and is the only component of the index that is negative. Business conditions continue to show a patchwork economy, although the number of industries with negative conditions has fallen. Still, much of the strength remains restricted to a narrow subset of (largely services based) industries. Despite the rise in conditions, **forward orders** were a little lower in the quarter, indicating only moderate momentum for business in the near-term. In contrast, expected future conditions (3 & 12 month ahead) improved.
- Firms' **confidence** jumped 4 points (to +4), which is consistent with the long-run average levels. The rise in confidence comes despite ongoing uncertainty in the global economy and sluggish domestic demand, but is somewhat consistent with strengthening near-term indicators – including rising business conditions. A lower AUD and oil prices, strong residential markets (in the big eastern states) plus the RBA's rate cuts this year are helping confidence as well. Confidence is now positive in all industries but mining, with retail now the most confident (up 10 to +14 points). This is a little surprising in light of sketchy consumer confidence, but the small business incentives from the Federal Budget appear to be helping.

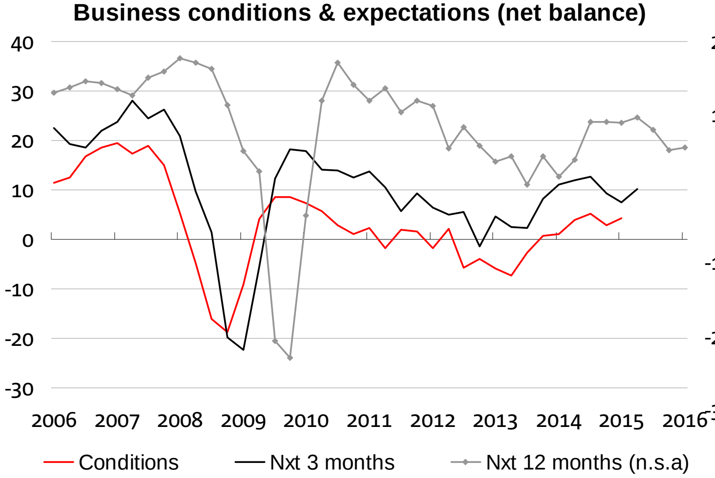




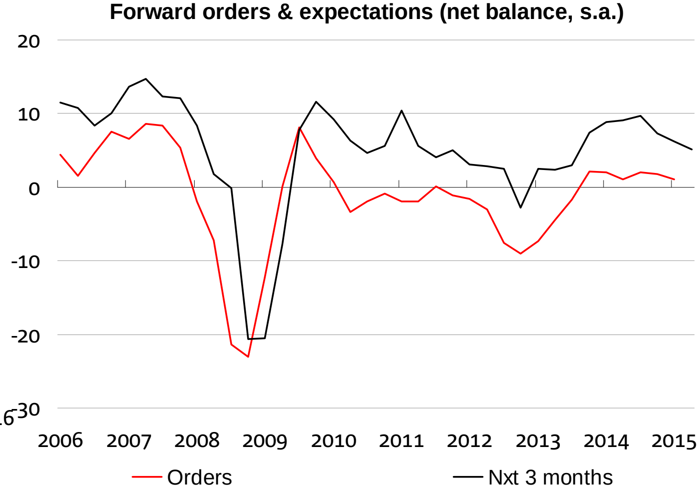
Forward indicators

- Despite NAB Economics' expectation for domestic demand to remain soft, firms' expectations for activity in their own business lifted in Q2, although both near and medium-term expectations are still below recent peaks. An improvement is consistent with strengthening confidence levels so far this year. Other leading indicators are generally mixed. Forward orders were down slightly and are subdued at just +1 index point, and expected orders (3 months) eased as well. Conditions in the 'bellwether' wholesale industry improved, but continue to be very weak with this industry heavily impacted by AUD depreciation (see page 11). Orders are highest in construction (+6), consistent with strong residential building approvals, and weakest in mining (-23).
- Stocks can also be an indicator of near-term activity. Although trading conditions remained positive, the relatively moderate orders index and eroding confidence seem to be discouraging firms from re-stocking more aggressively, particularly given limited prospects for stronger demand in the short term. Expected stocks (3 months ahead) remained at zero, but improved.

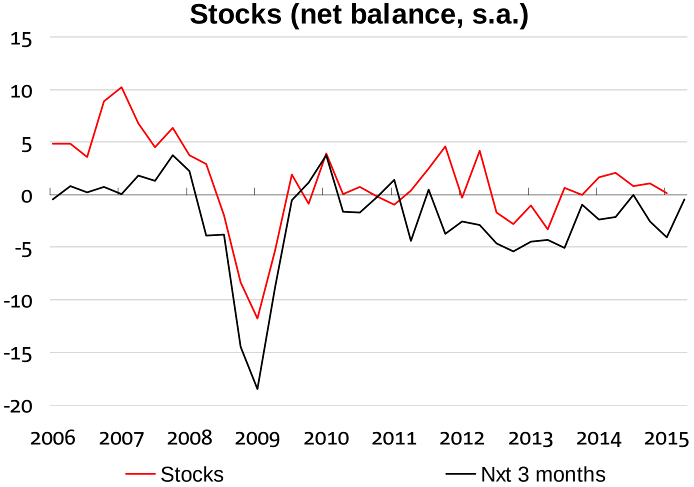
Expectations for 'own business' conditions lift slightly



Orders recovery stalls at moderate levels



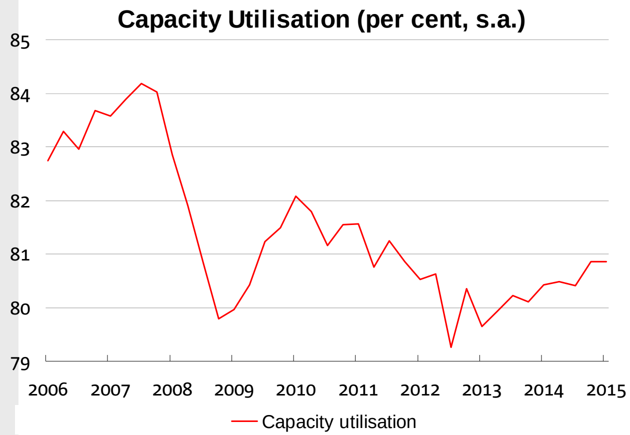
Lacklustre orders is discouraging more aggressive re-stocking



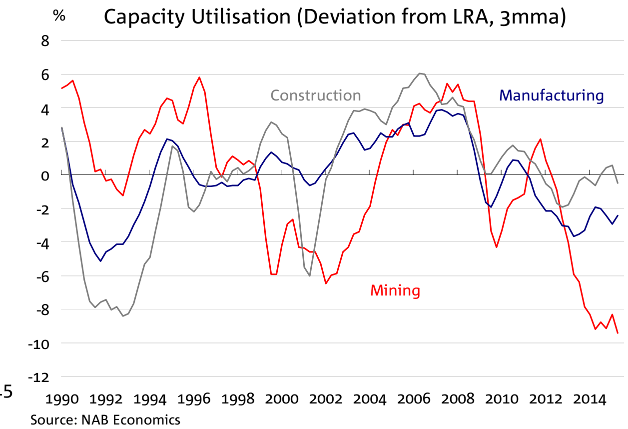
Forward indicators (cont.)

- Capacity utilisation in Q2 was unchanged at 80.9%, which is above long-run average levels, while the more timely monthly survey suggested a notable reduction in spare capacity late in the quarter. The upward trend in utilisation rates is an encouraging sign for future business investment activity, but while less spare capacity provides less of a constraint, firms are still requiring very high rates of return before committing to new investment projects (see June NAB Monthly Business Survey). Capacity utilisation rates vary across industries, with rates in retail and other service sectors above long-run average, while all others are below average (mining is lowest).
- According to the NAB survey measure of business capital expenditure, current business investment activity has lifted from the lows of recent years, and hit its highest level since late 2013 in Q2. The mining capex index for Q2 was the worst performing among the major industries, at -23 points, followed by transport/utilities at -3 points. Construction capex was surprisingly weak (-2) which likely reflects a sharp drop in mining construction activity – offsetting stronger residential construction. In contrast, current capex is highest in recreation & personal services (+23), followed by retail (+21). Nevertheless, the NAB expected capex index suggests growth may lift notably in the next 12 months, even though expectations eased in Q2. However, mining investment is under represented in our survey, meaning the degree of offset coming from the mining sector may not be fully captured. Capex expectations 12 months ahead are negative for mining and wholesale, but positive elsewhere.

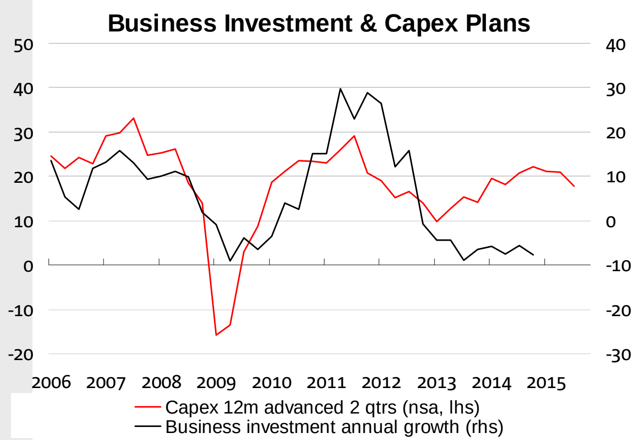
Capacity utilisation rates are trending upward – lowering constraint on capex



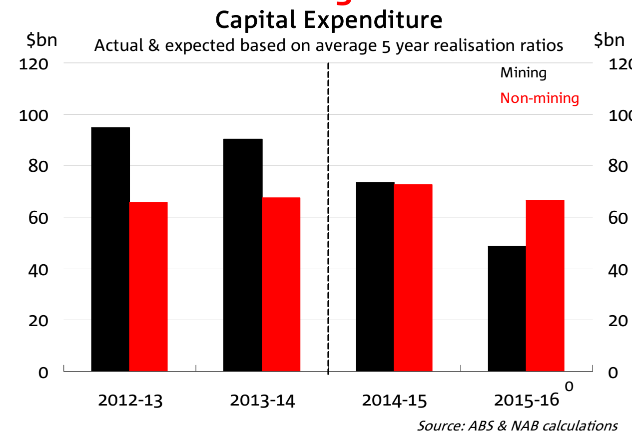
Spare mining capacity rising as investment boom ends



Capex intentions suggests a return of non-mining investment



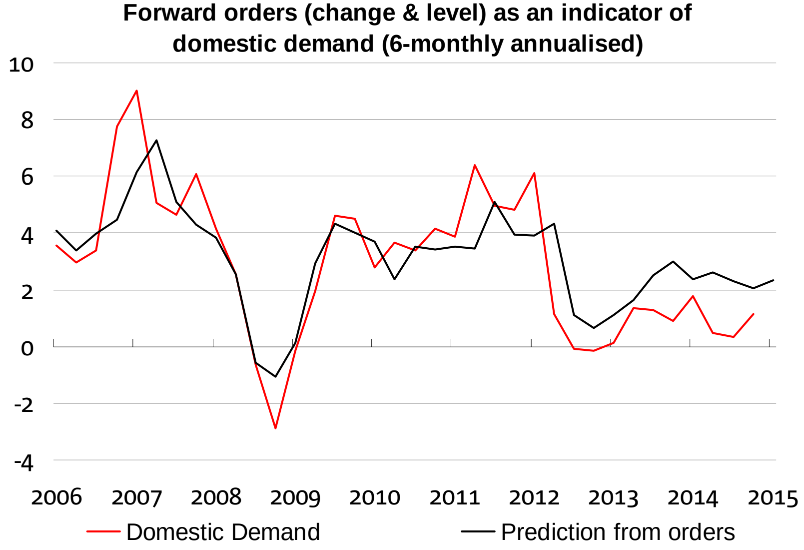
ABS survey showing further falls in non-mining investment



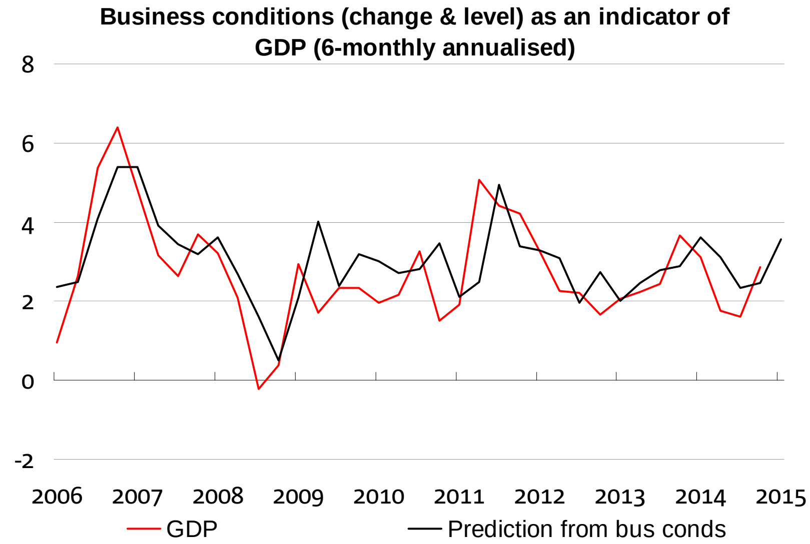
Implications for forecasts For more information see latest Global & Australian Forecasts

- Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has continued to suggest stronger growth than the national accounts, although the gap narrowed in Q1 2015. Nevertheless, applying forward orders from Q2 to our model suggests that predicted demand growth will lift a little more in Q2.
- In contrast, our business conditions model under-predicted GDP growth in Q1. Based on robust business conditions in June, our model implies further improvements in GDP growth for Q2.
- However, applying business conditions derived from our ‘wholesale leading indicator’ would imply somewhat weaker GDP growth in the coming quarter than the actual index, although this sector does appear more adversely impacted by the depreciation of the AUD. Wholesale conditions are currently -8 points, while transport and utilities (another intermediate industry that can provide leading signals) are also negative at -7 points.

Orders point to stable better domestic demand



Conditions point to up-tick in GDP

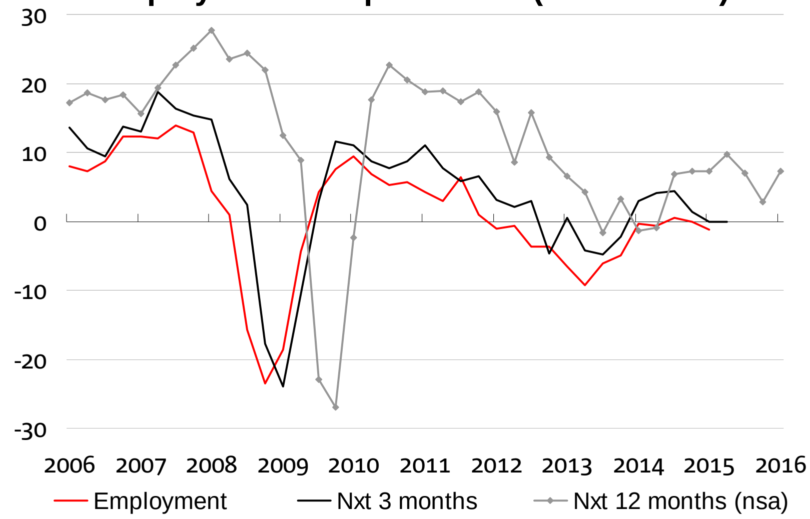


Labour Market

- The employment index was slightly softer in Q2 (down 1 to -1 index points), suggesting relatively modest rates of employment growth. This would be consistent with our view that unemployment will remain elevated for some time. Despite a drop in the employment index, average hours worked rose to 39.8 hours (from 39.7 hours) in Q2 2015, but this follows a much larger fall last quarter; ABS data show average hours work were down slightly in Q2.
- Near-term employment expectations were unchanged at a soft 0 index points, but it is encouraging to see longer-term expectations pick up. Soft near-term demand is somewhat consistent with our forecast for the unemployment rate to hold around 6¼% from late 2015, but is counter to recent trends in ABS statistics. Official labour employment growth has lowered the unemployment rate. The unemployment rate eased to 5.9% in May, although it lifted back to 6% in June.
- Firms continue to report relative ease finding suitable labour.

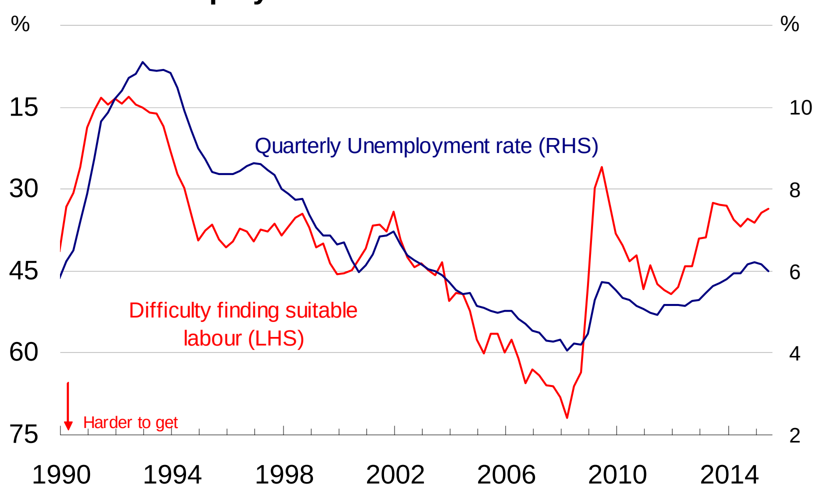
Longer-term employment expectations up

Employment & expectations (net balance)



Labour still relatively easy to find

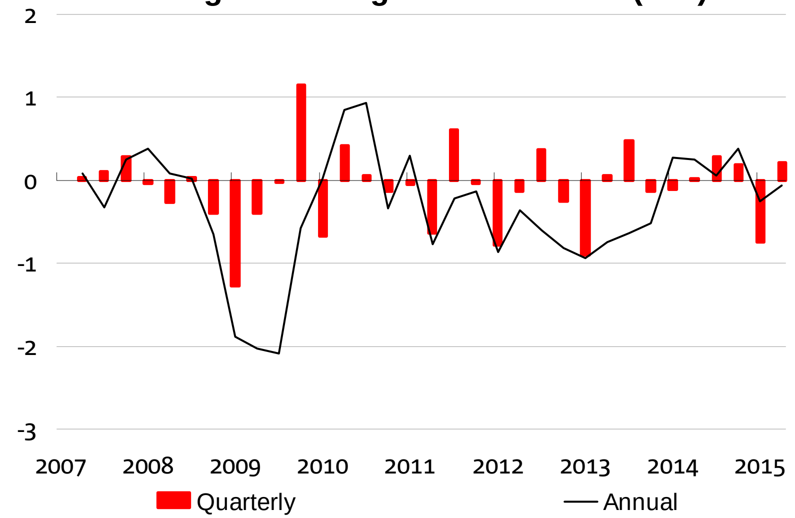
Unemployment rate & labour constraints



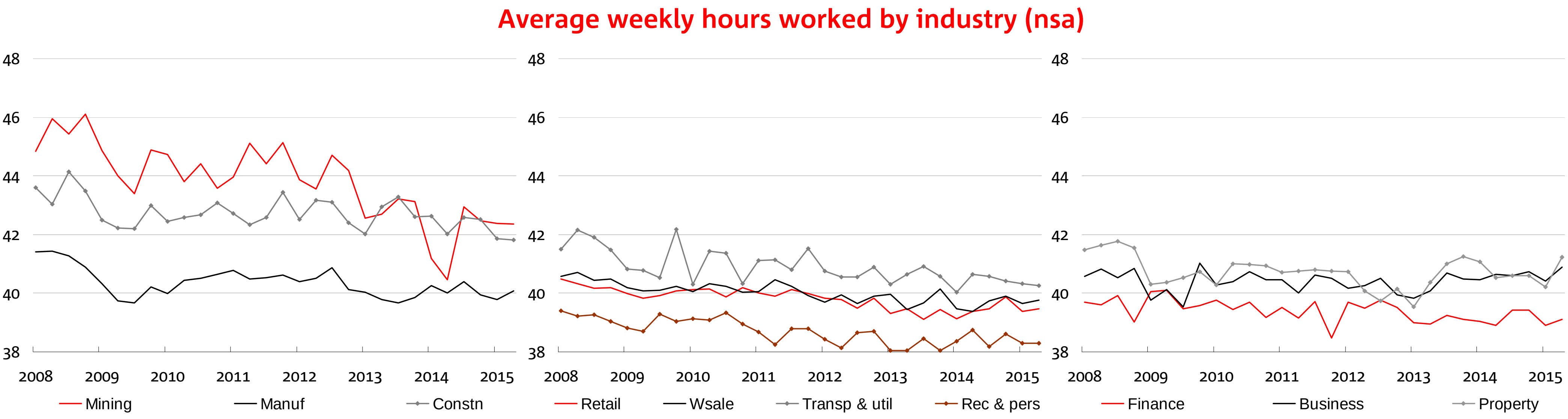
Sources: ABS; NAB

Average hours marginally higher

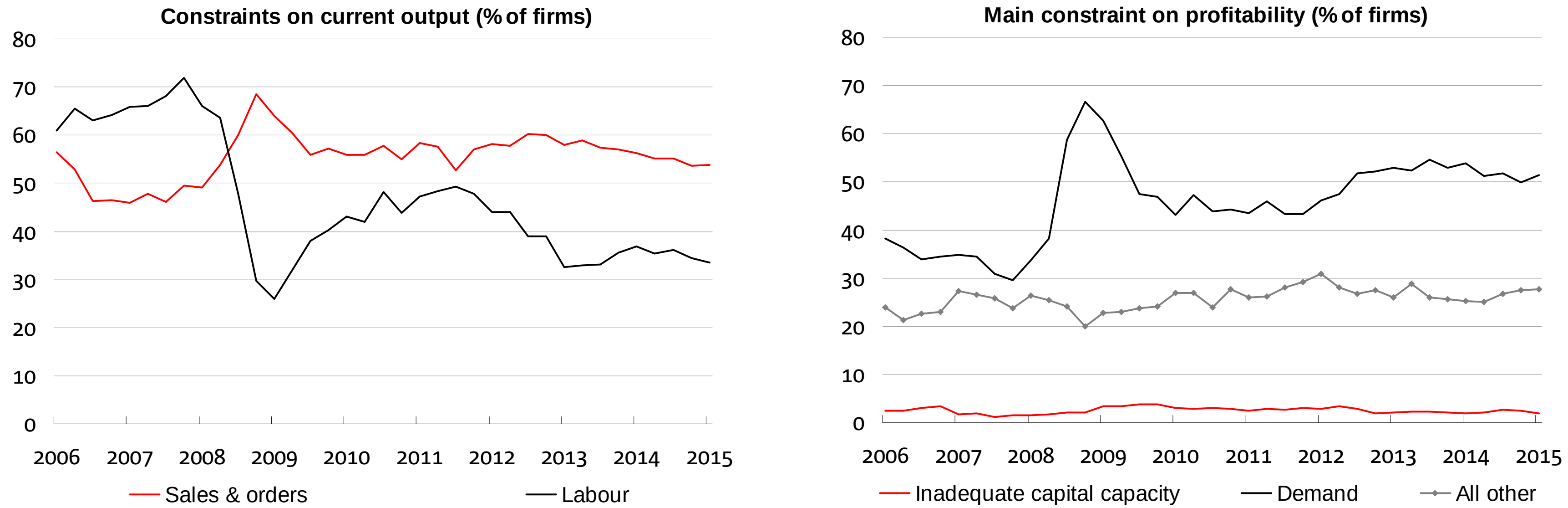
Change in average hours worked (nsa)



Labour Market (cont.)



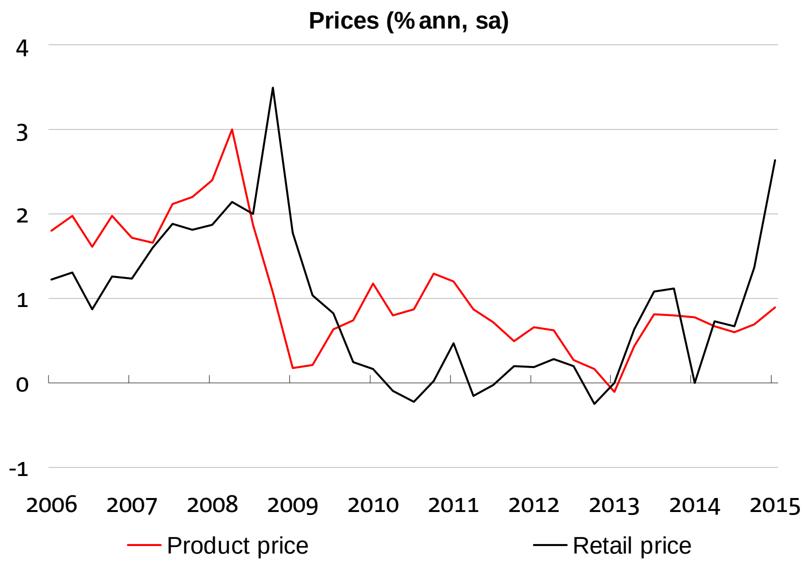
Major constraints on firm output & profits



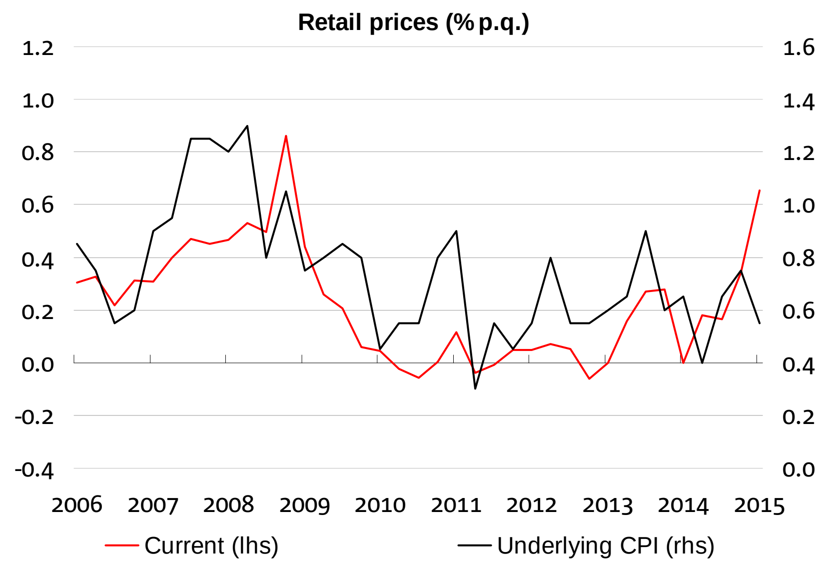
Inflation pressures

- With capacity utilisation rates on the rise, the potential for inflation pressures to emerge rises as well. Indeed, the survey is suggesting an up-tick in inflationary pressures during Q2. Inflation pressures are particularly prevalent in retail, while aggregate price inflation is still relatively subdued. Final product prices growth lifted to a still relatively modest 0.9% annualised. Purchase cost inflation was a little softer in Q2, while labour cost inflation was a little stronger (both were 0.4% at a quarterly rate).
- Retail price inflation accelerated the most in the quarter (up 0.3 ppts to 0.7%, quarterly rate), while recreation & personal services and manufacturing output inflation decelerated. Mining prices continued to fall, but by less than firms reported last quarter (from -1.2% to -1.0% at a quarterly rate) – deflation is consistent with falling commodity prices. Quarterly prices growth was strongest in retail and wholesale (0.7% & 0.6% in the quarter respectively). In the survey, a number of retail and wholesale firms indicated they were raising prices in response to the falling AUD. There was mixed evidence of this in the official CPI release for Q2, although this may flow through in coming quarters.
- Labour and purchase costs have continued to outstrip growth in firms' final product prices, and consequently the survey's profit margins index remains very weak – despite some improvement in the quarter. After easing in Q2, purchase cost are now in line with labour costs although slack in the labour market is still keeping labour costs fairly subdued. Some firms are indicating that AUD depreciation has contributed to their purchase costs. With the AUD expected to continue on a downward track into early 2016, importing firms are likely to experience ongoing pressure from purchase costs. However, already soft global inflation pressures (particularly in China) should help provide some offset for imported goods – providing some relief for both firms and households.

Price growth broadly steady, although retail inflation up sharply



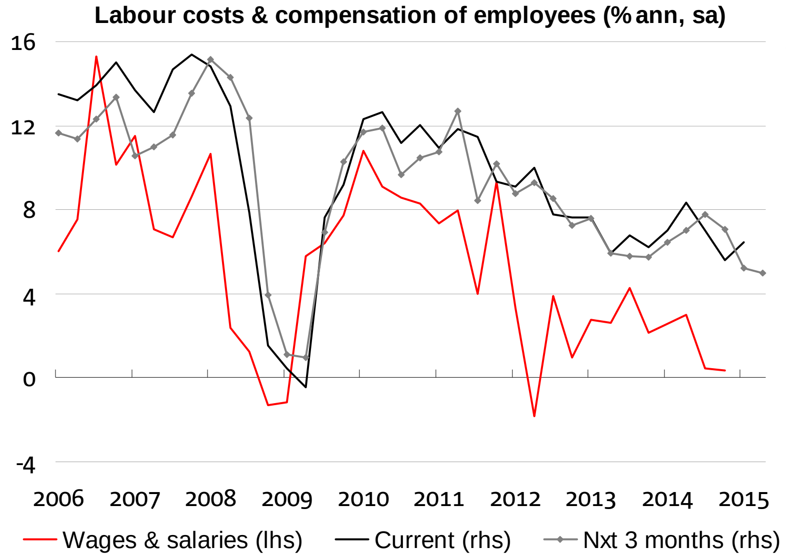
Retail price growth up, but ABS core CPI eased



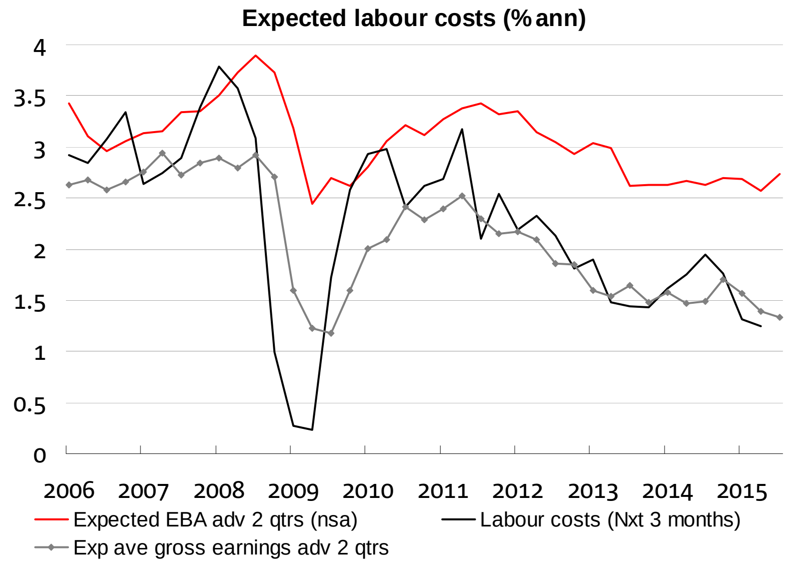
Labour costs (details) and expectations for AUD, rates and inflation

- Annualised labour costs growth picked up to 1.6% in the quarter, which is still well below the series average of around 3.0% since 1989. The subdued pace of growth is consistent with soft employment conditions and a published unemployment rate of 6% (only marginally below the more than decade high of 6.3% in January). Wage pressures are likely to remain fairly benign, with wage increases under EBAs expected to average just 2.7% over the next year, or 1.8% after allowing for productivity offsets.
- On average, businesses revised up their expectation for short-term interest rates, anticipating rates will remain unchanged – last quarter firms expectations suggested a 50% probability of a 25bp cut. This is consistent with NAB Economics expectation for the RBA to wait and see how recent cuts play out – in light of improving short-term partials and ongoing strength in residential markets. Exchange rate expectations (6-months-ahead) lifted slightly in the quarter to US$0.78, from US$0.77, with firms apparently not anticipating the depreciation that has already taken place following the survey period.
- Medium-term inflation expectations remained soft, with 62% of respondents expecting inflation to remain below 3% (up slightly from the previous quarter), slightly less than a third (31%) expecting inflation of 3-4% (was 33%). Less than 3% of firms believe inflation is a serious problem (down slightly from last quarter), while 26% believe it is a minor problem (29% previously).

Soft labour market restrain labour cost pressures



Labour cost expectations easing

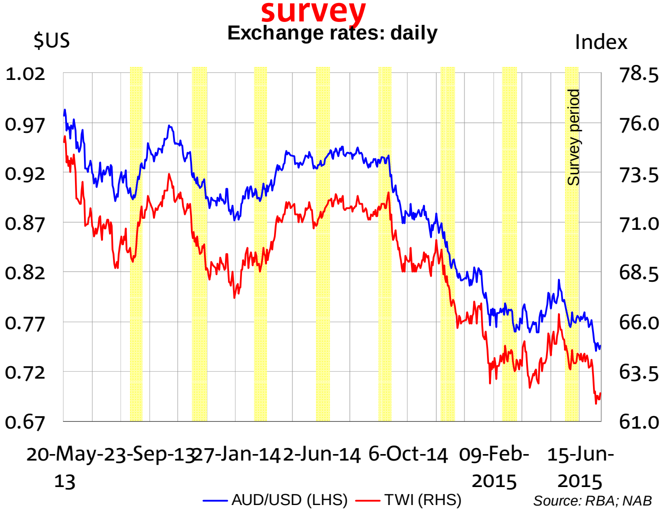


	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.8	3.0	3.5	2.6	1.8	2.9	2.6	2.7	2.7
Productivity offset	0.6	1.0	1.0	1.3	0.8	1.5	0.7	0.7	0.9
Net EBA growth	1.1	2.0	2.5	1.3	1.0	1.4	1.9	2.0	1.8

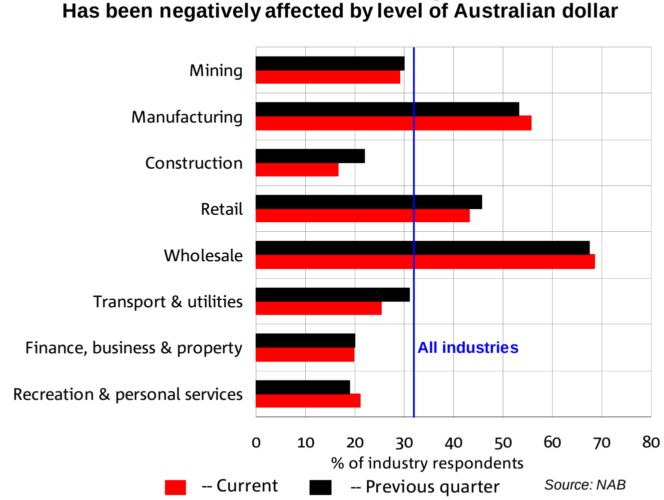
Business & the AUD

- 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 May and 11 June, when the exchange rate averaged $US 0.77 and 64.2 on a TWI basis. These levels are similar to the December survey period ($US 0.78 and 64.2 on a TWI basis) and above current rates (around $US 0.75).
- According to the survey, more than 30% of non-farm businesses reported an adverse impact from the AUD (similar to Q1 2015), which is not too surprising given the similar level of the AUD since the last survey (although there was some notable volatility during the period. Unsurprisingly, most industries recorded only minor changes in the impacts felt from the AUD in the quarter, although both transport & utilities and construction recorded a notable improvement/less negative impacts – although it is possible that this reflects a lagged impact from previous depreciation. Looking over a longer period (12 months), most industries appear to have seen a benefit from AUD depreciation. Retail, transport & utilities and wholesale are the exceptions, which could reflect higher import costs.
- It is not surprising that the implications for import costs is having a negative impact on wholesalers, with flow on effects to retailers – despite helping competitiveness against overseas online retailers. Retail, along with recreation & personal services, are the industries where firms are most uncertain over how to manage their currency risk (p3). It is still wholesale and manufacturing that are most adversely affected by the level of the AUD, while service sectors appear to be most insulated, which could reflect less import competition and few foreign input costs.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy used by affected firms (and rose further), especially in wholesale, manufacturing and retail. Firms indicated a slightly higher preference for 'conservative' measures of managing currency pressures in the quarter. In particular, more firms are focussing on hedging, reducing overheads and downsizing – the latter two still being most prevalent in mining.

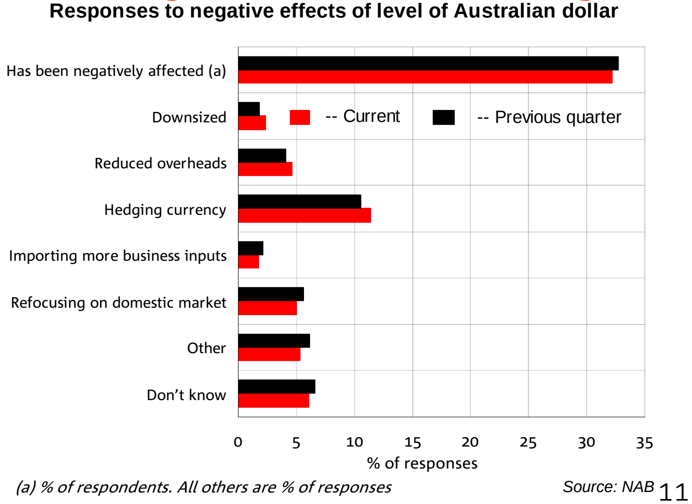
Exchange rate similar to previous survey



Most industries seeing similar impact from AUD as last quarter



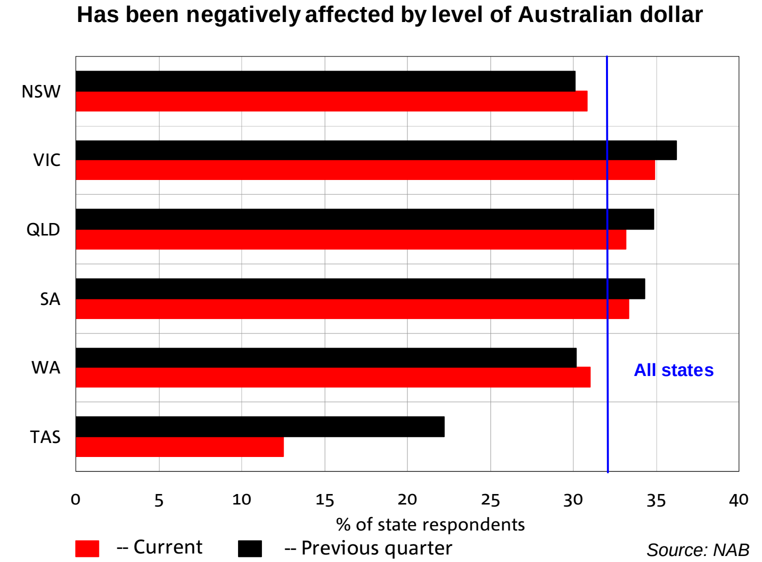
Hedging is most popular, but more focussing on 'conservative' strategies



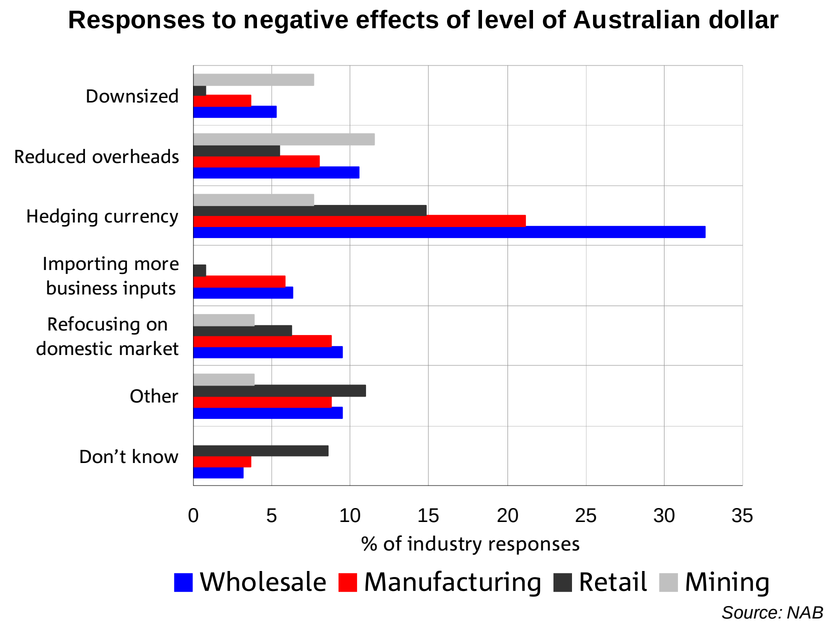
Business & the AUD (cont.)

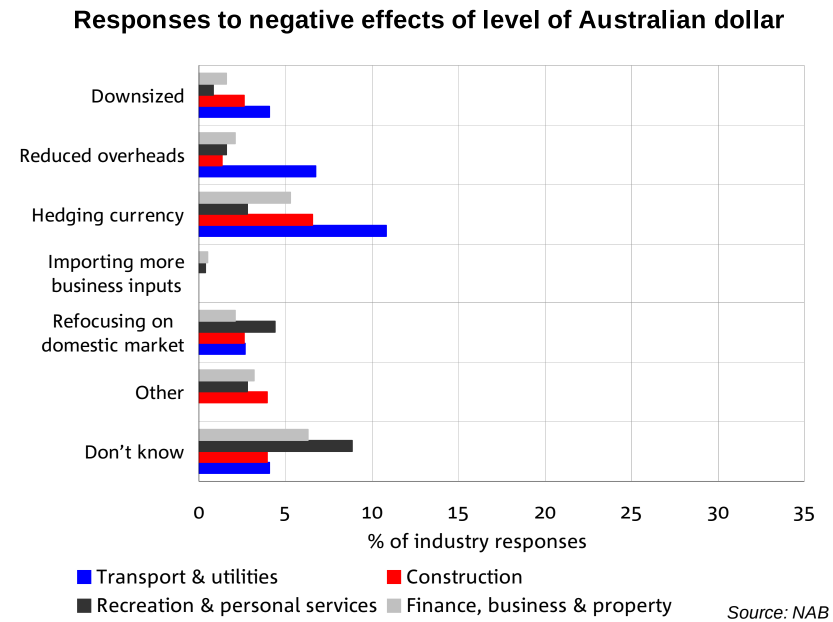
- Negative exchange rate effects eased slightly for most mainland states in the quarter, although NSW and WA worsened marginally. Negative impacts are still most prevalent in Victoria despite improving in the quarter (consistent with the larger manufacturing base) . Tasmania reported the biggest decrease in the share of firms negatively affected by the AUD and the overall proportion is still smallest of the states.
- Queensland is on par with South Australia as the second most affected state. This is despite the benefits for their large commodity and tourism sectors from the AUD depreciation seen over the past year.
- Similarly, the deterioration in WA in recent quarters is not consistent with the expected implications for the mining industry.
- Hedging was important for wholesalers, manufacturers and retailers, although this is the most common strategy for most industries. Downsizing and cost reduction is used most in wholesale and mining, although still only employed by a relatively small proportion of firms. Nevertheless, cost reduction is the preferred strategy of mining firms.

Impact of $A mixed across states



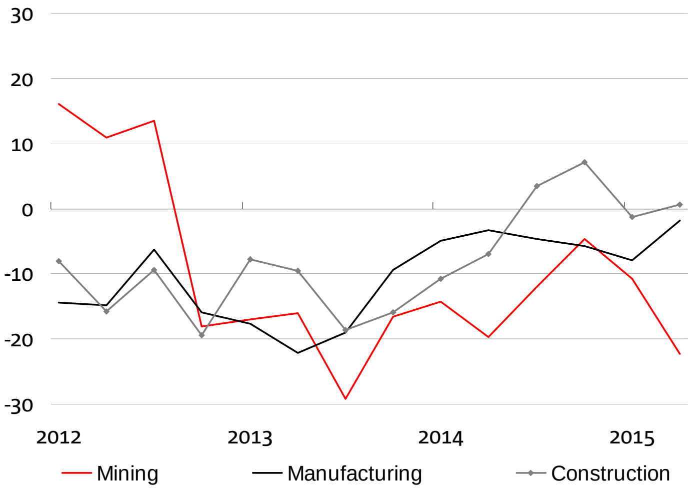
Hedging preferred in wholesale and manufacturing

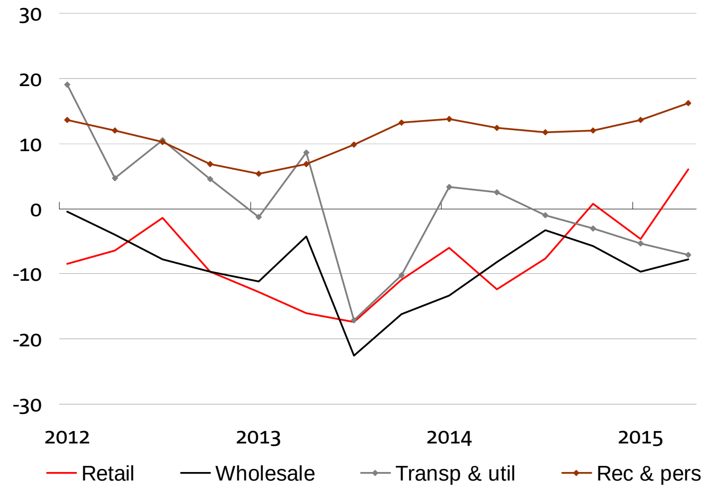


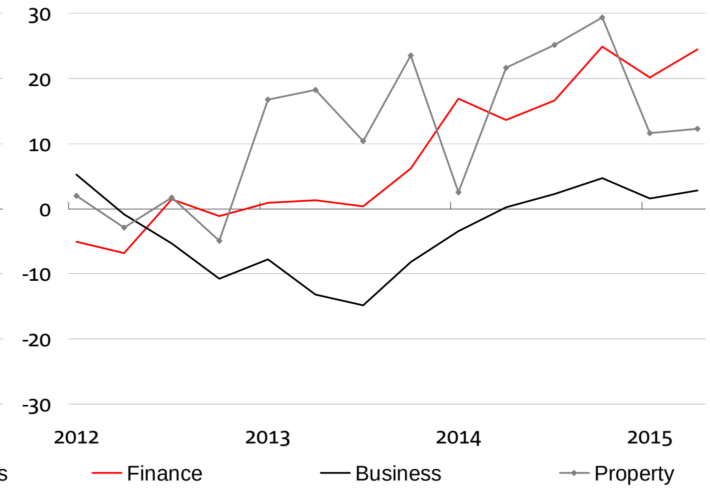


More details on industries

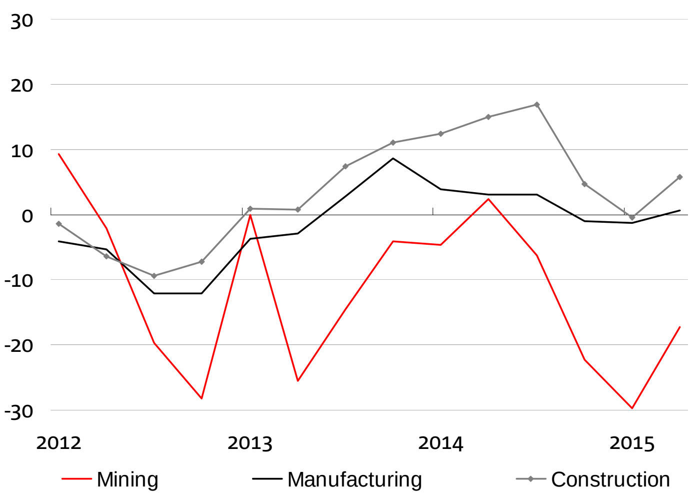
Business conditions by industry (net balance)

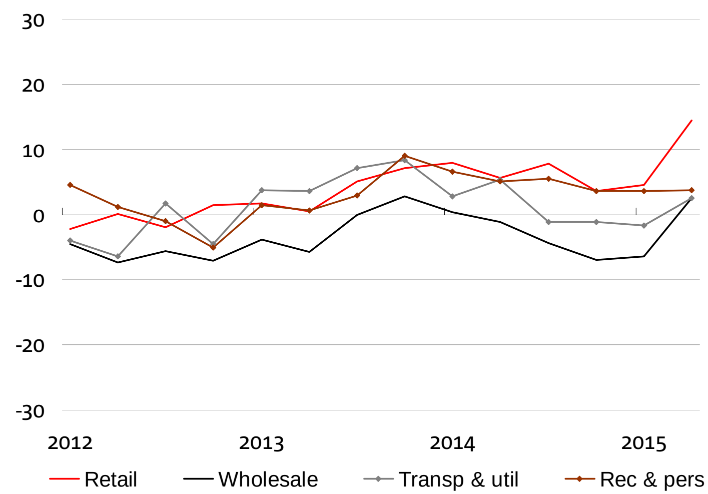


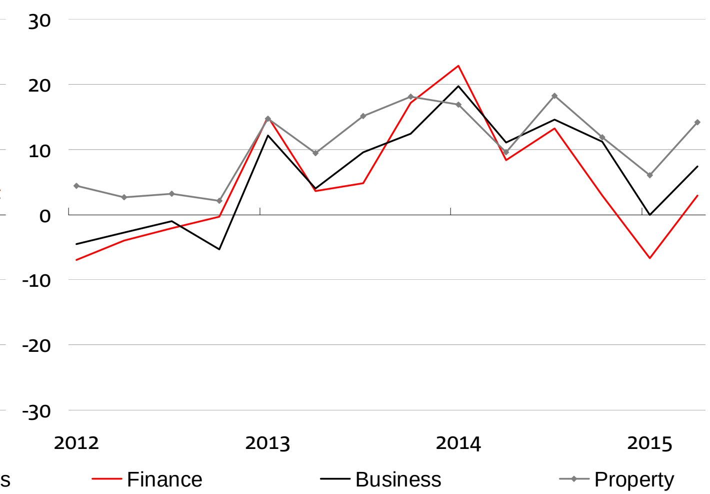




Business confidence by industry (net balance)

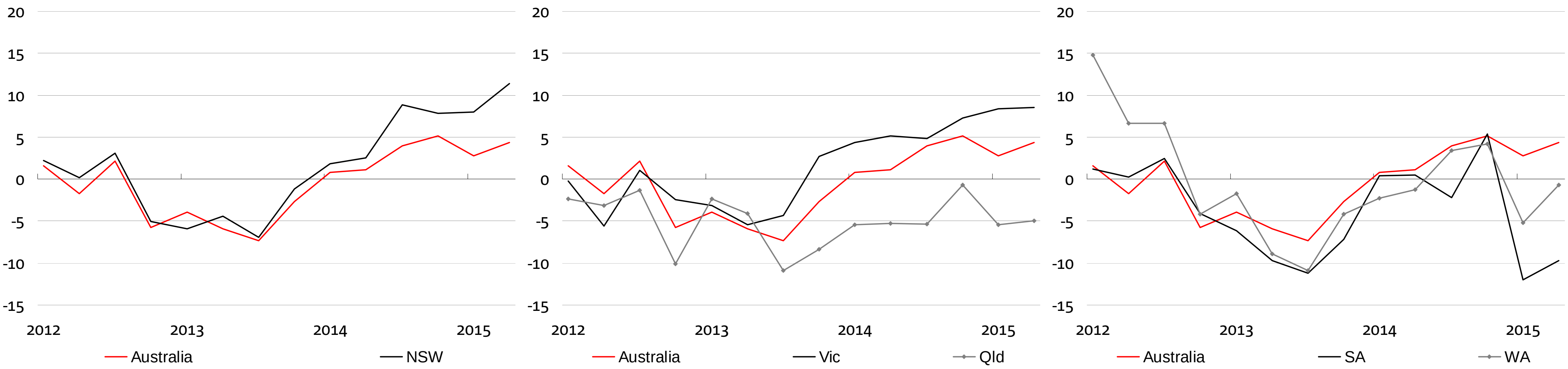




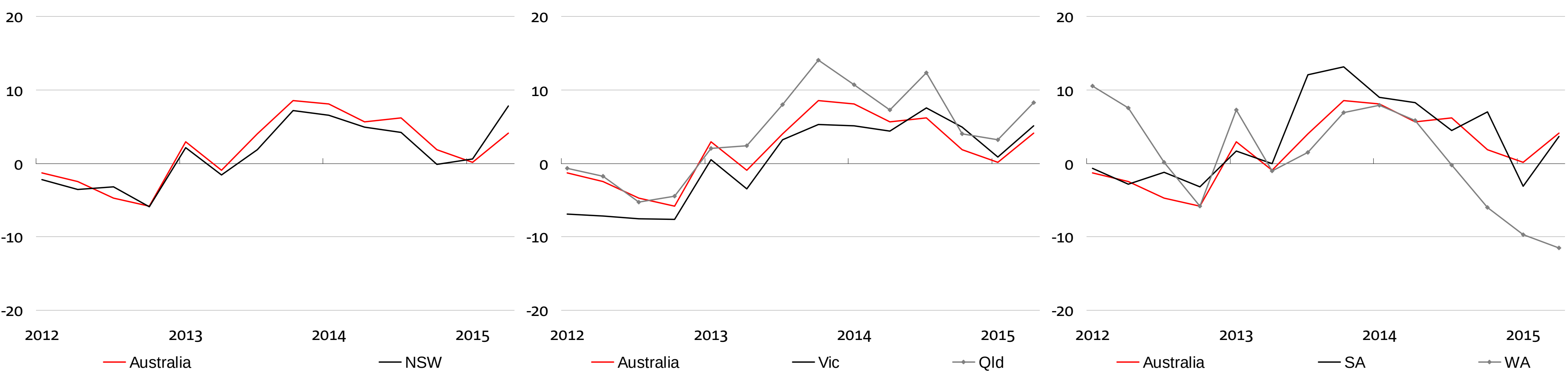


More details on states

Business conditions by state (net balance)



Business confidence by state (net balance)



Data appendix

	Quarterly					Monthly				
	2014q2	2014q3	2014q4	2015q1	**2015q2**	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Confidence	6	6	2	0	**4**	0	3	3	8	10
Conditions	1	4	5	3	**4**	3	6	4	6	11

	Quarterly					Monthly				
	2014q2	2014q3	2014q4	2015q1	**2015q2**	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Trading	4	9	10	7	**11**	6	11	11	12	20
Profitability	0	4	6	1	**4**	2	8	5	8	10
Employment	0	-1	0	0	**-1**	-1	0	-2	-1	1

	Quarterly [(a)]					Monthly				
	2015q1	2015q2	2015q3	2016q1	2016q2	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Conditions	3	**4**				3	6	4	6	11
Conds. next 3m	9	8	**10**							
Conds. nxt 12m	24	24	25	18	**19**					
Orders	2	**1**				2	-1	-1	2	5
Orders next 3m	7	6	**5**							

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

	Quarterly [(a)]					Monthly				
	2014q2	2014q3	2014q4	2015q1	**2015q2**	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Capacity utilis.	80.5	80.4	80.9	**80.9**		80.4	80.5	80.2	80.9	81.3
Stocks current	2	1	1	**0**		0	0	1	0	-2
Stocks next 3m	-2	0	-3	-4	**0**					

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

Constraints on output (% of firms)*	2014q2	2015q1	2015q2
Sales & orders	55.2	53.7	**53.9**
Labour	36.1	34.4	**33.5**
Premises & plant	19.3	18.9	**19.2**
Materials	9.8	8.7	**10.6**

Main constraints on profitability (% of firms)*	2014q2	2015q1	2015q2
Interest rates	2.8	3.1	**2.5**
Wage costs	9.7	11.8	**12.0**
Labour	6.3	5.3	**4.4**
Capital	2.6	2.5	**2.0**
Demand	51.8	49.9	**51.5**
All other	26.8	27.4	**27.6**

** not s.a.*

Data appendix (cont.)

	Quarterly[a]					Monthly				
	2015q1	2015q2	2015q3	2016q1	2016q2	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Empl current	0	**-1**				-1	0	-2	-1	1
Empl next 3m	1	0	**0**							
Empl nxt 12m	7	7	10	3	**7**					

(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	1.8	3.0	3.5	2.6	1.8	2.9	2.6	2.7	2.7
Productivity offset	0.6	1.0	1.0	1.3	0.8	1.5	0.7	0.7	0.9
Net EBA growth	1.1	2.0	2.5	1.3	1.0	1.4	1.9	2.0	1.8

State Tables

	Quarterly					Monthly				
	2014q2	2014q3	2014q4	2015q1	**2015q2**	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Business conditions										
NSW	3	9	8	8	**11**	9	11	10	12	12
VIC	5	5	7	8	**9**	8	14	9	9	18
QLD	-5	-5	-1	-5	**-5**	-8	-5	1	-3	0
SA	1	-2	5	-12	**-10**	-13	0	-10	-10	3
WA	-1	3	4	-5	**-1**	-3	4	-12	9	5

	Quarterly					Monthly				
	2014q2	2014q3	2014q4	2015q1	**2015q2**	2015m02	2015m03	**2015m04**	**2015m05**	**2015m06**
Business confidence										
NSW	5	4	0	1	**8**	2	4	4	13	12
VIC	4	8	5	1	**5**	2	4	0	8	7
QLD	7	12	4	3	**8**	5	5	8	10	6
SA	8	4	7	-3	**4**	-10	-8	4	6	4
WA	6	0	-6	-10	**-12**	-14	-1	-1	-8	10

Author details

Economic Research

Alan Oster
Chief Economist
+61 3 8634 2927

Riki Polygenis
Head of Australian Economics & Commodities
+61 3 8634 1663

James Glenn
Senior Economist – Australia & Commodities
+61 3 9208 8129

Group Economics
Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Riki Polygenis
Head of Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Amy Li
Economist – Australia
+(61 3) 8634 1563

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Karla Bulauan
Economist – Industry Analysis
+(61 3) 86414028

International Economics
Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia
Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

UK/Europe
Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532