more give, less take

NAB Quarterly Business Survey

by NAB Group Economics

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September Quarter 2015

National Australia Bank

Key Points:

- The NAB Quarterly Business Survey provides valuable insight into Australian business, and is the longest running survey of its type in the country (over 25 years). This Survey offers a more in-depth probe into the conditions facing Australian business than the usual monthly survey, and also provides an indication of how firms perceive the outlook for their respective industries.
- The September quarter NAB Business Survey confirms the trend improvement current condition in the non-mining economy, while the outlook is also looking notably better. In contrast, confidence softened considerably although this is largely a reflection of the timing of the survey – prior to the Liberal Party leadership resolution, and at a time when emerging market concerns were particularly high.
- Lower interest rates and AUD depreciation appear to be having the desired effects, although this varies by industry. Interestingly, firms indicate that they are facing some challenges when it comes to currency movements, although this largely reflects negative impacts on the wholesale, retail and transport sectors – industries where firms tend to have a heavy reliance on imports. In contrast, areas such as personal services and mining are reporting a much more positive impact.
- Leading indicators were generally more positive in Q3 2015. Forward orders jumped to their highest level since late 2009, while expectations for conditions in 3 and 12 months time both improved. A lift in capacity utilisation and capex plans for the next 12 months is encouraging, although firms continue to suggest they require high 'hurdle rates' of return before committing to investment.
- Product price inflation remained relatively subdued at an annualised rate of 0.7% (0.2% in the quarter), reflecting both softer labour cost growth and modest purchase cost inflation, as well as a degree of margin compression.

Table 1: Key quarterly business statistics*

	2015q1	2015q2	**2015q3**		2015q1	2015q2	**2015q3**
		Net balance				*Net balance*	
Business confidence	1	4	**0**	Trading	8	11	**18**
Business conditions				Profitability	2	4	**11**
Current	3	5	**11**	Employment	0	-1	**1**
Next 3 months	8	10	**13**	Forward orders	2	1	**5**
Next 12 months	18	19	**25**	Stocks	1	0	**2**
Capex plans (next 12)	21	18	**20**	Exports	1	1	**3**
% change							
Labour costs	0.4	0.4	**0.3**	Retail prices	0.4	0.6	**0.4**
Purchase costs	0.5	0.4	**0.5**				
Final products prices	0.2	0.2	**0.2**	Capacity utilisation rate	80.9	80.8	**80.9**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 24 Aug to 9 Sep 2015, covering over 920 firms across the non-farm business sector.

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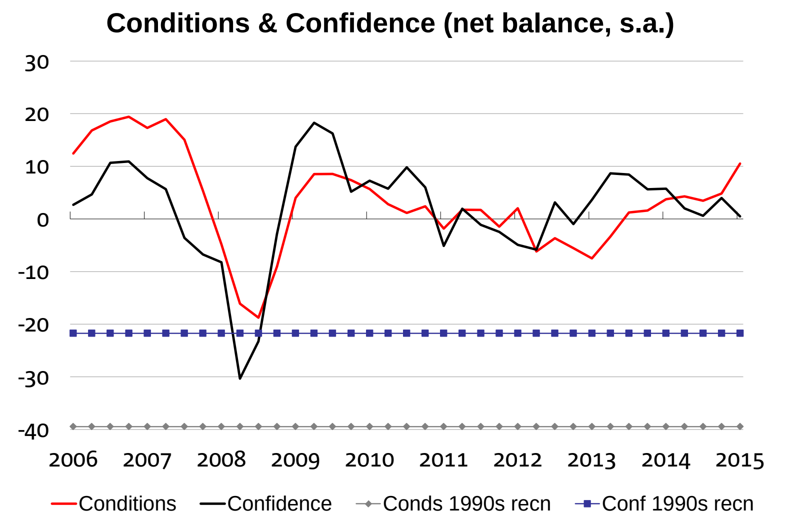
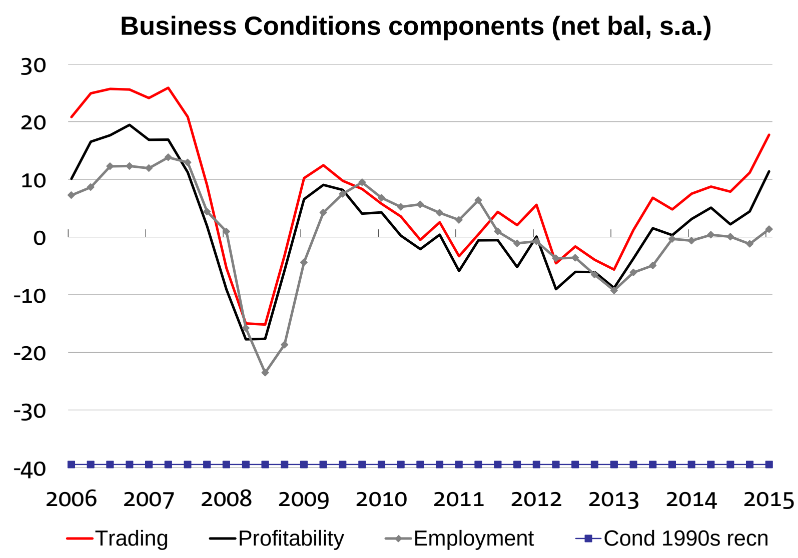
Business conditions & confidence

- Business **conditions** improved strongly in the September quarter, rising to +11 index points (from +5), which is its highest level since early 2008 and is consistent with the growing evidence that non-mining sectors of the economy are staging a more pronounced recovery. This outcome for the quarter is above the long-run average of +1 index point, suggesting that non-mining domestic demand growth strengthened in Q3 (see p5). All components of business conditions (trading, profitability, employment) were higher, although the improvement was the most apparent in trading and profitability – both reaching their highest level since early 2008. The lift in the employment index was more modest, although there were signs elsewhere in the Survey that conditions in the labour market are tightening (p6), and the monthly Survey suggested a more visible increase late in the quarter. Although the survey points to a lift in the non-mining economy, outcomes continue to vary significantly across industries, suggesting that we remain in a 'patchwork economy'. Much of the strength remains in services based industries, and to a lesser extent retail trade.
- Firms' **confidence** was a little disappointing in Q3, falling 4 points (to 0), which is below the long-run average level. The fall in confidence is likely a reflection of the timing of the Survey, which took place just prior to the change in Liberal leadership and at a time when recent concerns over emerging markets were at their peak. The more timely monthly Business Survey showed that confidence posted a partial recovery in September once these issues settled down. Just like with conditions, confidence varies across industries with construction and retail apparently the most buoyant – likely related to residential property market performance.
- While confidence is difficult to predict, firms continue to point to subdued demand conditions as the main **constraint on their confidence**. Interestingly, however, firms are indicating that the availability of suitable labour is of growing significance to confidence going forward.
- **Forward orders** picked up notably in the quarter, indicating growing momentum for business in the near-term. Orders are highest in construction, consistent with an elevated pipeline of residential projects, while orders are lowest in mining.

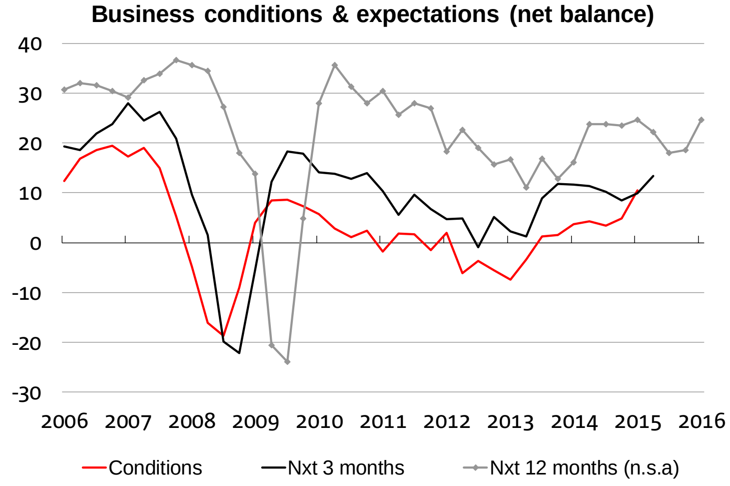




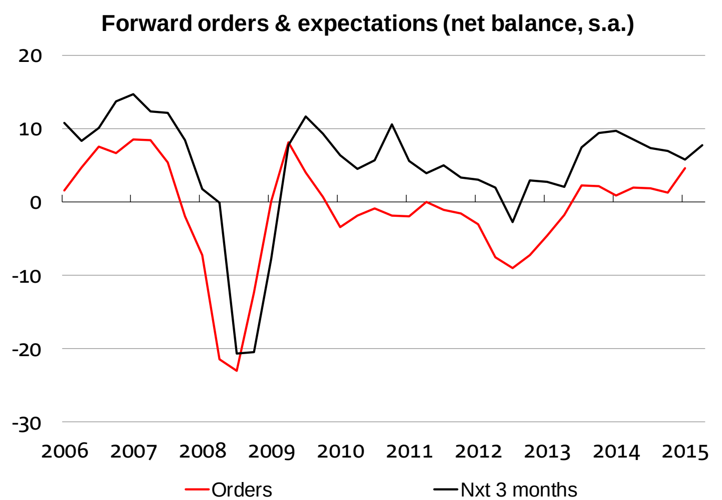
Other leading indicators

- NAB Economics' continue to expect relatively soft domestic demand growth over the coming years. This does, however, mask the considerable divergence between mining and non-mining sectors of the economy, which is expected to continue as the economy readjusts to the end of the mining boom. Firms' expectations for activity in their own business confirm this view, with both near and medium-term expectations lifting in Q3 to be at or above their most recent peaks. Other leading indicators are also looking more positive. Forward orders were up to a solid +5 index points, and expected orders (3 months ahead) lifted as well, although the latter remains below the levels seen last year.
- Stocks can also be an indicator of near-term activity, but the stocks index has only improved modestly despite strengthening trading conditions and higher orders. Eroding confidence (at the time of the quarterly survey) may be discouraging firms from re-stocking more aggressively. Higher import costs due to AUD depreciation may be contributing, but firms continue to report subdued purchase cost inflation. Expected stocks (3 months ahead) remained around zero as well.

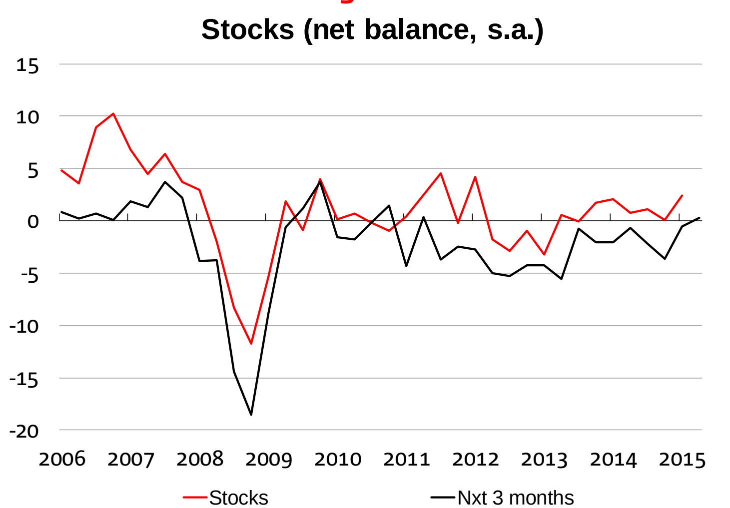
Expectations for 'own business' conditions strengthen



Orders are recovering, but still somewhat subdued



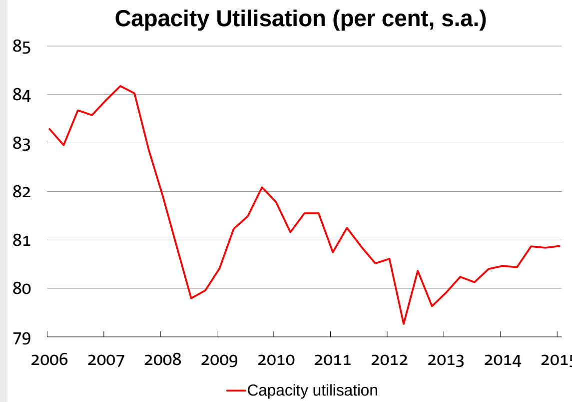
Firms reluctant to re-stock despite stronger sales



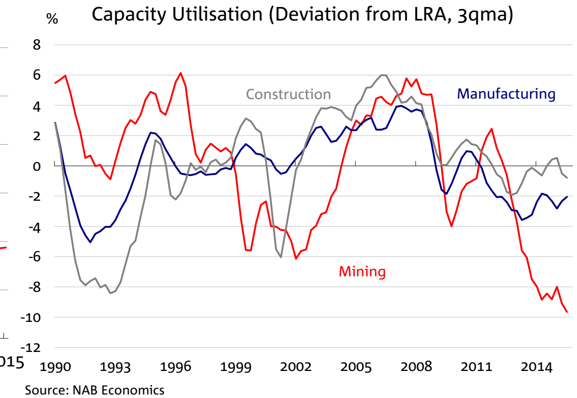
Business investment indicators

- Capacity utilisation in Q3 was up slightly to 80.9%, which is above long-run average levels (80.6%), while the more timely monthly survey suggested spare capacity was depleted even further late in the quarter. The upward trend in utilisation rates is an encouraging sign for economic activity, the labour market and future business investment. But, while less spare capacity provides an incentive to invest, firms are still requiring very high rates of return before committing to new capex (around 14%). 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 to stabilised at around long-run average elevated levels. Unsurprisingly, the mining capex index for Q3 was the worst performing among the major industries, at -9 index points, followed by transport/utilities at -2. The capex index is positive for all other industries, and highest in finance/ property/ business services (+16).
- When asked about their future capex expectations, firms are generally more upbeat, which is in contrast to the weak expectations in the ABS Capex Survey. The NAB capex index for the next 12 months suggests investment growth should already be stronger and holding at relatively elevated levels. 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 manufacturing, but positive elsewhere.

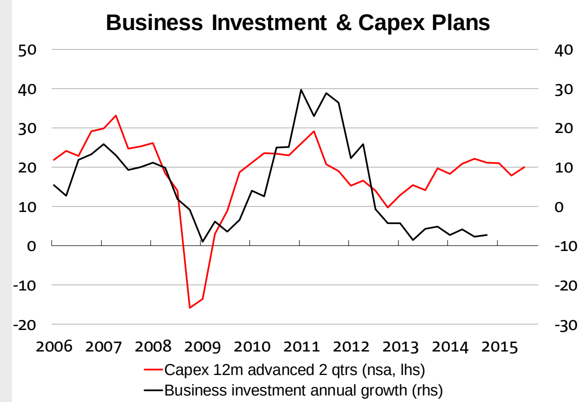
Rising capacity utilisation a positive lead on activity & investment



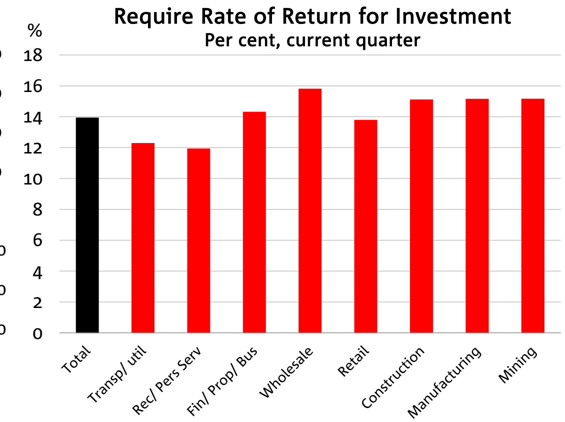
But, capital intensive sectors showing ample capacity



Capex intentions suggests a return of non-mining investment



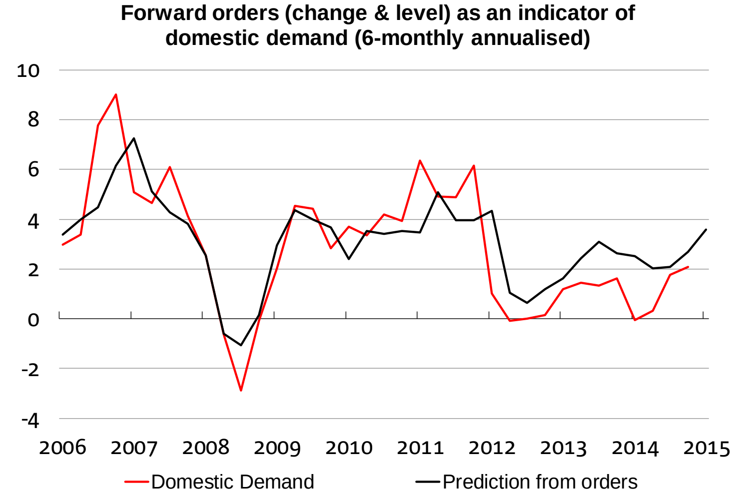
Firms indicate elevated 'hurdle rates' to investment



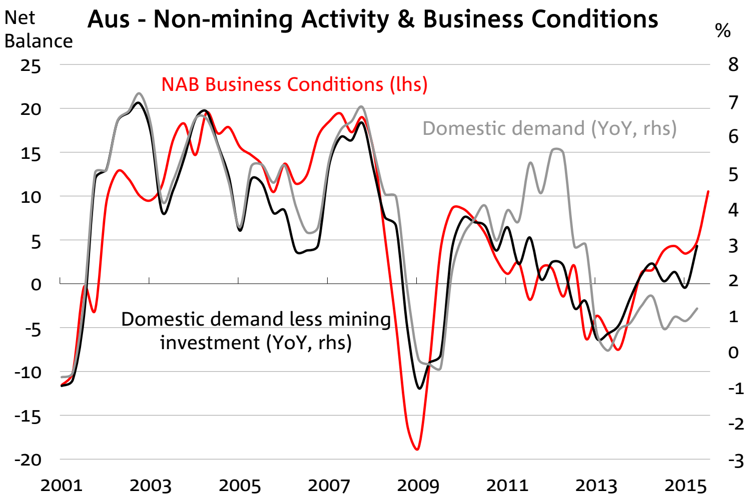
Implications for forecasts For more information see latest Global & Australian Forecasts

- 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 recent quarters. Nevertheless, applying forward orders from Q3 to our model suggests that predicted demand growth will lift notably in Q3.
- Similarly, our business conditions model over-predicted GDP growth considerably in Q2. Based on robust business conditions in September, our model again implies a potential lift in GDP growth for Q3. However, intermediate industries such as wholesale and transport are recording negative conditions, which suggest some downside risks to growth – although factors such as the AUD depreciation could be driving this result.
- Given the significant influence the mining investment boom is having on domestic demand in Australia, the NAB Business Survey has a closer relationship with non-mining demand. If this relationship holds, business condition suggest a notable pick-up in non-mining demand in Q3.

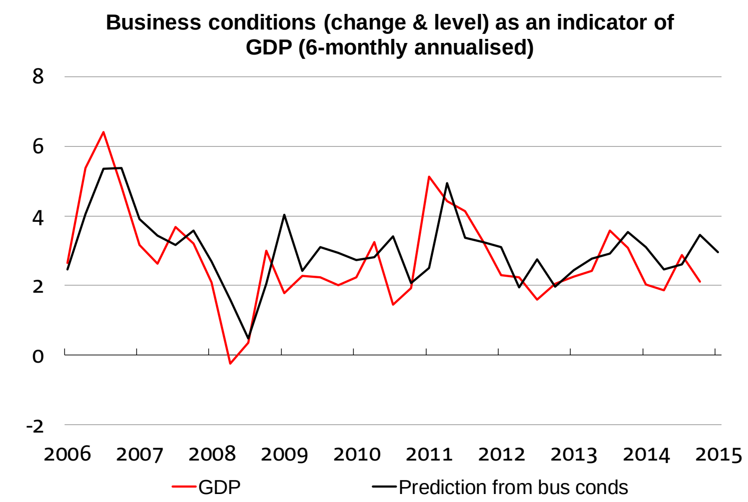
Orders point to stable better domestic demand



Conditions coincide with non-mining demand



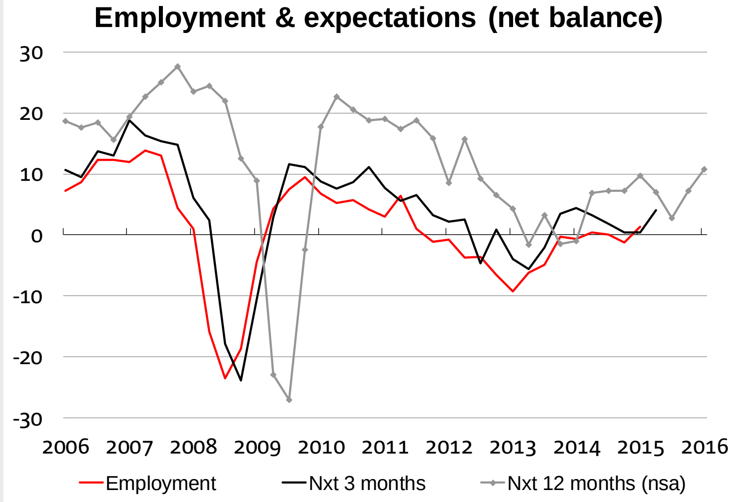
Conditions point to up-tick in GDP



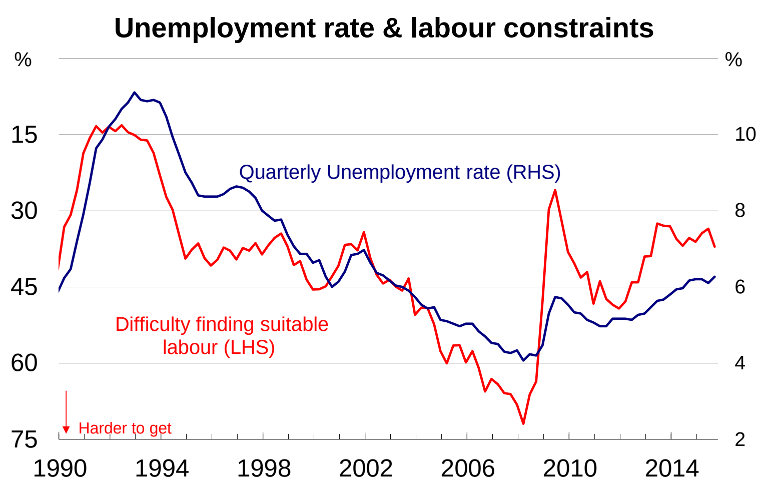
Labour Market

- The employment index was slightly stronger in Q3 (up 2 to +1 index point), suggesting relatively modest rates of employment growth. Average hours worked also rose to 39.9 hours (from 39.8 hours) in the quarter, building on the increase from Q2 2015.
- Near-term employment expectations increased to +4 index points, which is above its long-run average level. It is also encouraging to see longer-term expectations pick up to their highest level since late 2011. This would be consistent with our view that unemployment will remain elevated for some time, but will gradually improve (especially given the expectation for population growth to slow). While current employment conditions suggest jobs growth of about 15k per month – enough to keep the unemployment rate stable – the 12-month expectation is more consistent with job growth of around 17k per month over the next 6 months, which may be sufficient to see the unemployment rate ease a little from current levels.
- Firms continue to report relative ease in finding suitable labour, although it became slightly more difficult in the quarter. Nonetheless, firms suggested that the lack of suitable labour is becoming a much bigger constraint on future employment demand.

Employment expectations up

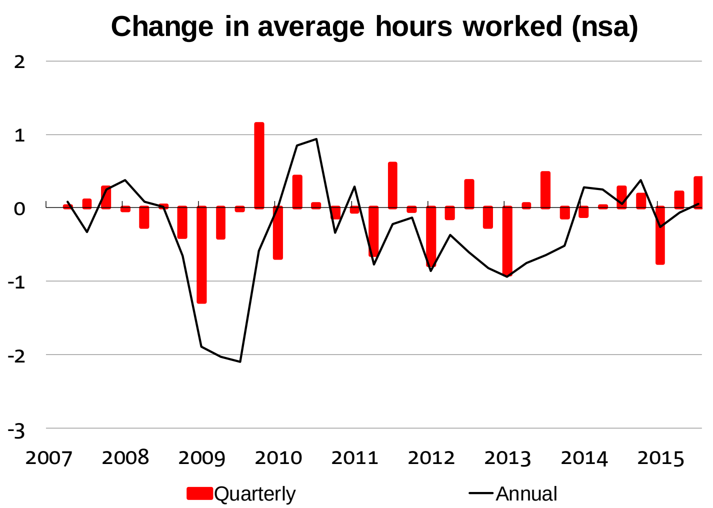


Labour still relatively easy to find



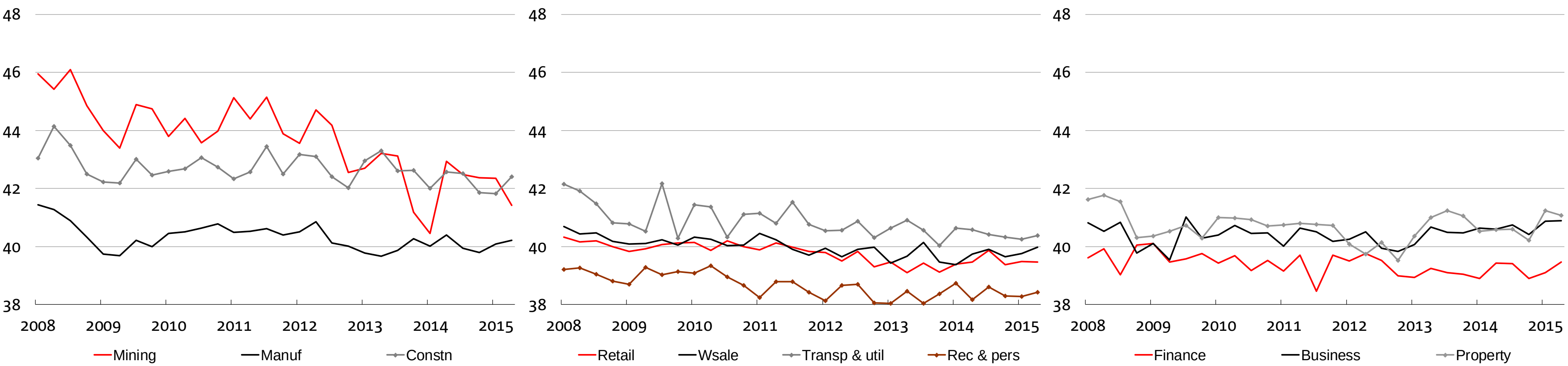
Sources: ABS; NAB

Average hours marginally higher



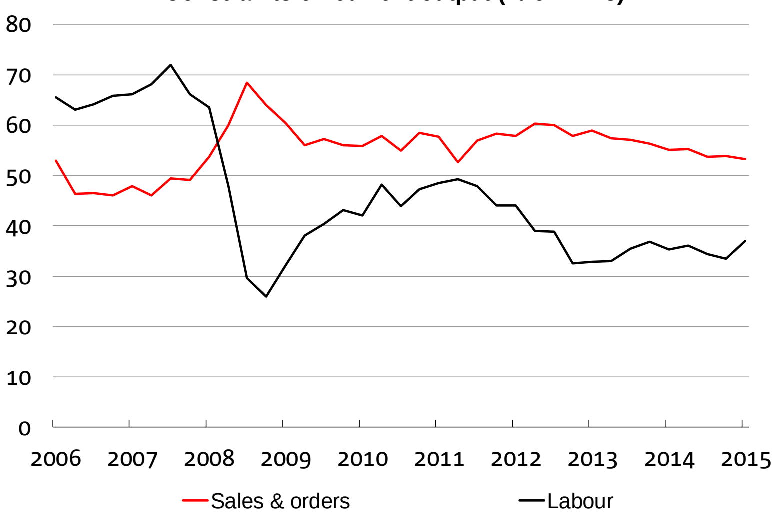
Labour Market (cont.)

Average weekly hours worked by industry (nsa)

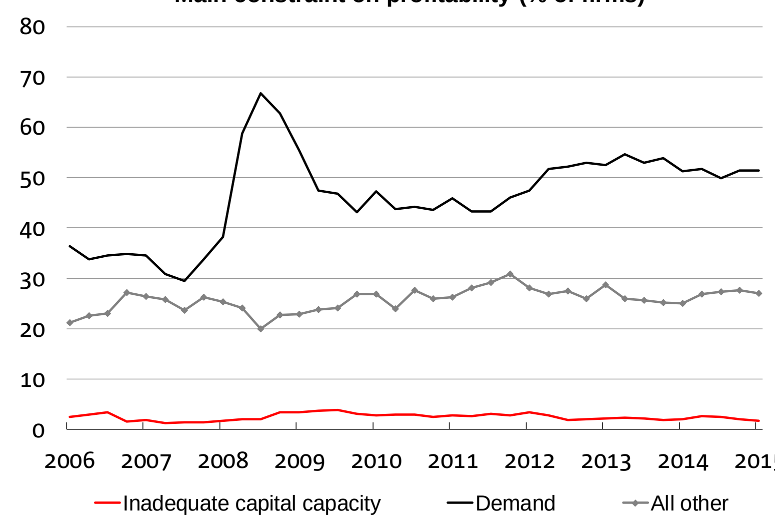


Major constraints on firm output and profits

Constraints on current output (% of firms)



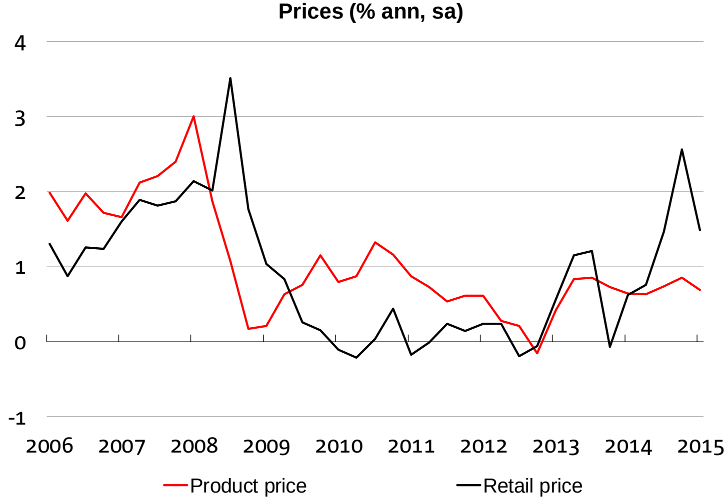
Main constraint on profitability (% of firms)



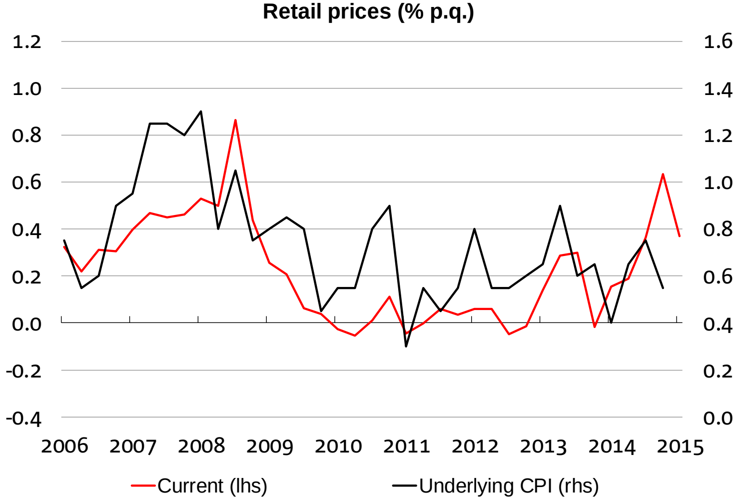
Inflation pressures

- Inflation pressures have been relatively subdued in the post-GFC period, but the apparent turnaround in non-mining activity and a lower AUD means that there is a growing potential for inflationary pressures to re-emerge. Despite this, the broader picture on inflation provided by the Business Survey suggests these pressures have remained relatively muted. The Survey does, however, suggest that there has been some pass-through from higher input costs into retail and wholesale prices growth.
- Final product prices growth eased to a still relatively modest 0.7% annualised and 0.2% quarterly rate. Purchase cost inflation was a little higher in Q3, while labour cost inflation eased (to be at 0.5% and 0.3% respectively at a quarterly rate). Wholesale price inflation accelerated the most in the quarter (up 0.2 ppts to 0.8%, quarterly rate) to levels fast approaching a two decade high, and while retail price inflation eased (down 0.3 ppt to 0.4%, quarterly rate) it remains relatively elevated. In the survey, a number of retail and wholesale firms indicated they were raising prices in response to the falling AUD. Nevertheless, inflation expectations for the next 3 months do not point to a significant increase, with final price inflation expected to remain around 1.1% at an annualised rate (1.3% for retail inflation).
- 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. However, with retailers now attempting to pass on some of their cost pressures, there was a notable improvements in the retail margins index in Q3 (although it remains slightly negative). This improvement, along with much stronger trading conditions for retail in Q3, suggests that a better demand environment may be allowing this pass-through of cost pressures to consumers – rather than necessarily suggesting that retailers have hit their limit for absorbing higher costs.

Price growth broadly steady, although retail inflation elevated



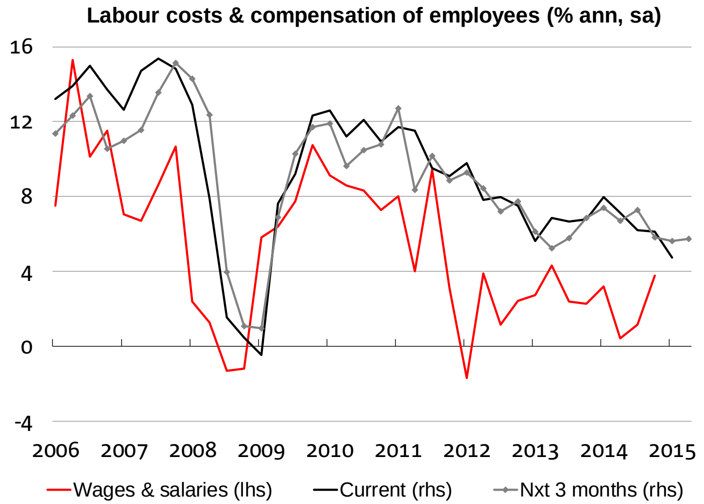
Retail price growth suggest upside to ABS core CPI measure



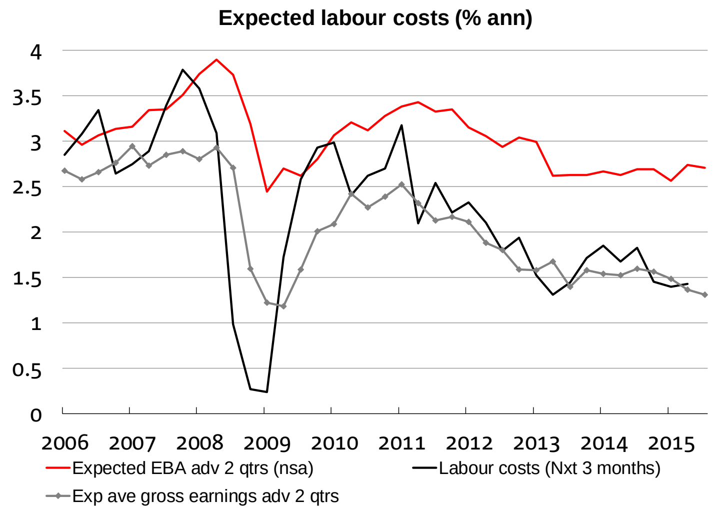
Labour costs (details) and expectations for AUD, rates and inflation

- Annualised labour costs growth eased to 1.2% in the quarter, which is well below the series average of around 2.9% since 1989. The subdued growth is consistent with soft (albeit improving) employment conditions and a published unemployment rate above 6%. Labour cost expectations (next 3 months) have also been steady at subdued levels. Wage pressures are likely to remain fairly benign, with wage increases under EBAs expected to average just 2.7% over the next year, or 1.9% after allowing for productivity offsets.
- On average, businesses revised up their expectation for short-term interest rates, but on average are still expecting rates will remain unchanged – 6-months-earlier 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 the non-mining recovery and residential markets play out (in light of global uncertainties and a policy induced tightening of credit conditions). Exchange rate expectations (6-months-ahead) fell in the quarter to US$0.71, from US$0.78.
- Medium-term inflation expectations remained soft, with 67% of respondents expecting inflation to remain below 3% (up from the previous quarter), slightly more than a quarter (27%) expecting inflation of 3-4% (was 31%). Less than 3% of firms believe inflation is a serious problem (up slightly from last quarter), while 26% believe it is a minor problem (unchanged from Q2).

Soft labour market restrain labour cost pressures



Labour cost expectations easing



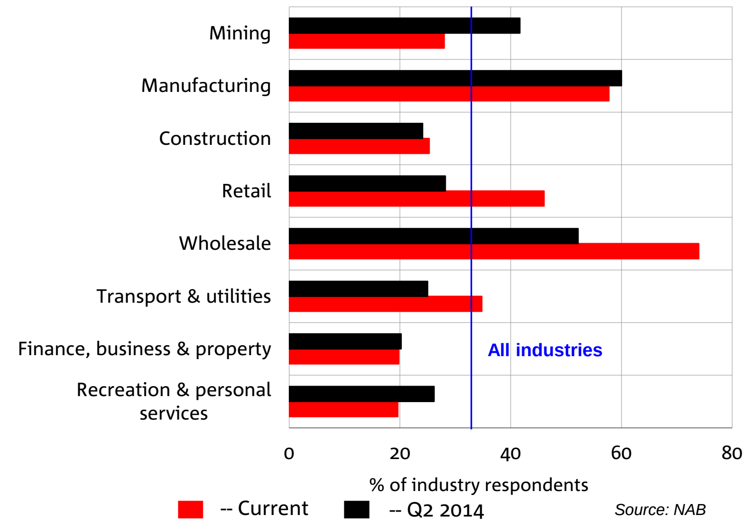
	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	2.3	2.7	3.2	2.3	2.4	2.5	2.8	2.6	2.7
Productivity offset	0.7	1.1	0.7	0.9	0.8	0.6	0.7	0.6	0.8
Net EBA growth	1.6	1.6	2.5	1.3	1.6	1.9	2.1	1.9	1.9

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 24 August and 9 September, when the exchange rate averaged $US 0.71 and 60.3 on a TWI basis. These levels are below those seen during the June survey period ($US 0.77 and 64.2 on a TWI basis) and below current rates (around $US 0.73).
- According to the survey, around a third of non-farm businesses reported an adverse impact from the AUD. This is up from Q2 2015, which is somewhat surprising given the lower level of the AUD since the last survey (although there has been a reasonable degree of currency volatility during the period). The share of firms reporting an adverse impact is also higher than a year ago when the AUD was valued much higher.
- The industry break-down gives some indication as to why this might be the case. In particular, much of the deterioration seems to stem from industries including wholesale, retail and transport, all of which have firms that could potentially have a high degree of import reliance – or have become more reliant on imports as a result of the elevated AUD in recent years.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy used by affected firms (and rose further). As the AUD has depreciated, firms appear to have become even more focussed on hedging and import substitution, as opposed to greater cost cutting (e.g. downsizing). Retail has the highest share of firms that are uncertain about what strategies to employ to manage currency risk, although firms in most industries appear to be more uncertain compared to last quarter).

Impact of lower AUD varies considerably across industries

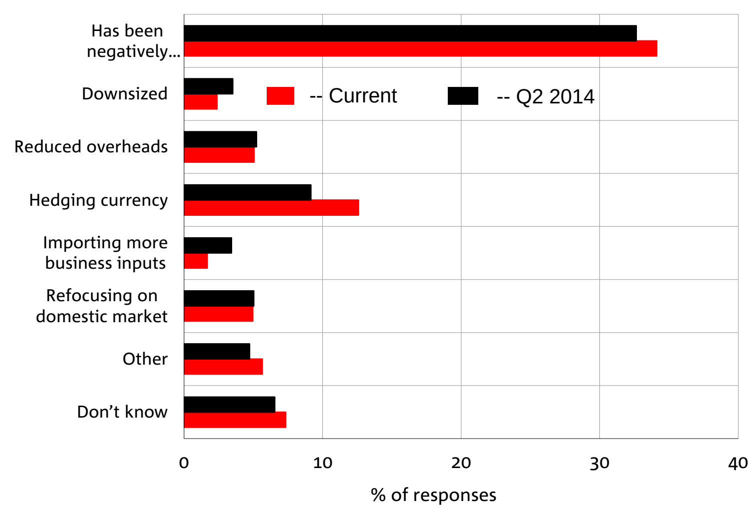
Has been negatively affected by level of Australian dollar



Source: NAB

Hedging and import substitution are main strategy to deal with lower AUD

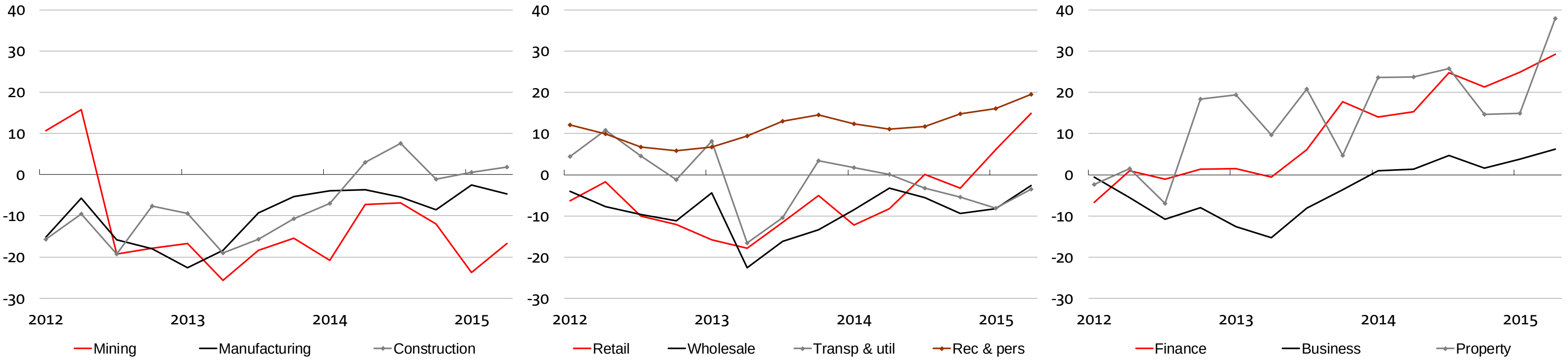
Responses to negative effects of level of Australian dollar



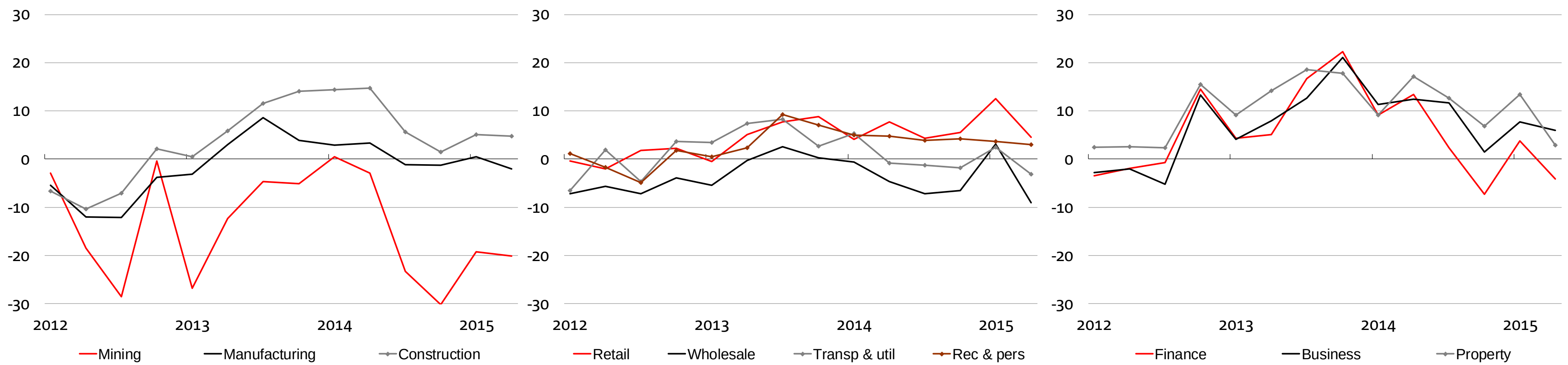
(a) % of respondents. All others are % of responses *Source: NAB*

More details on industries

Business conditions by industry (net balance)

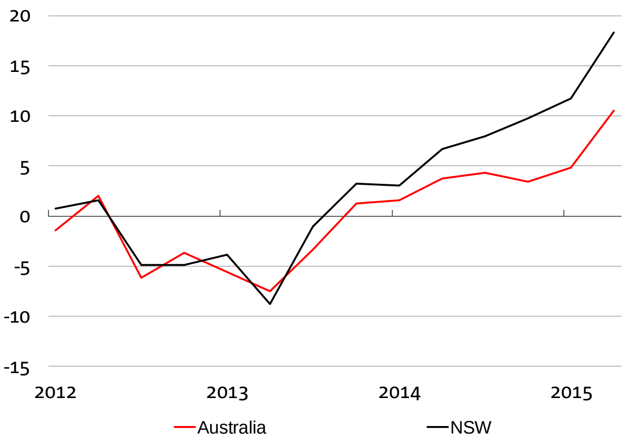


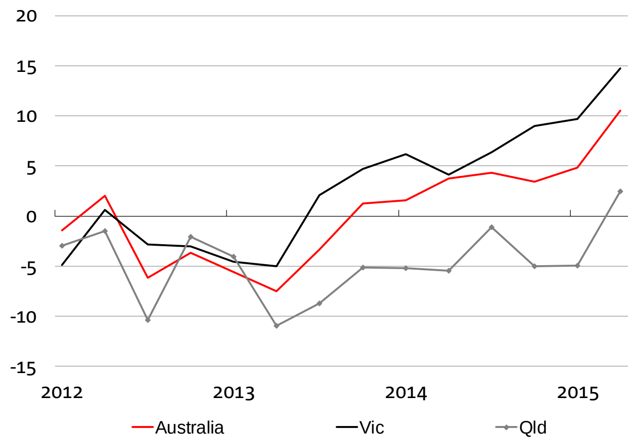
Business confidence by industry (net balance)

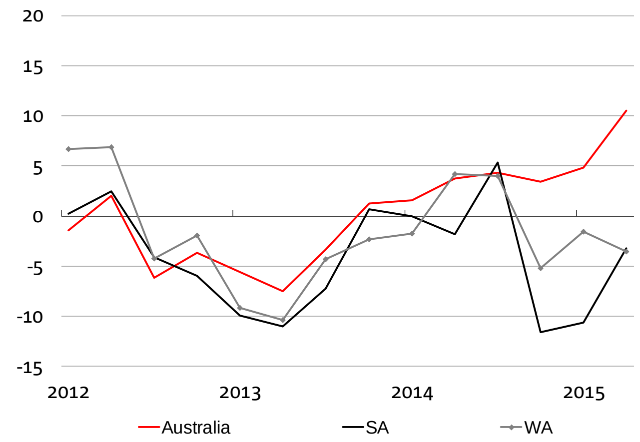


More details on states

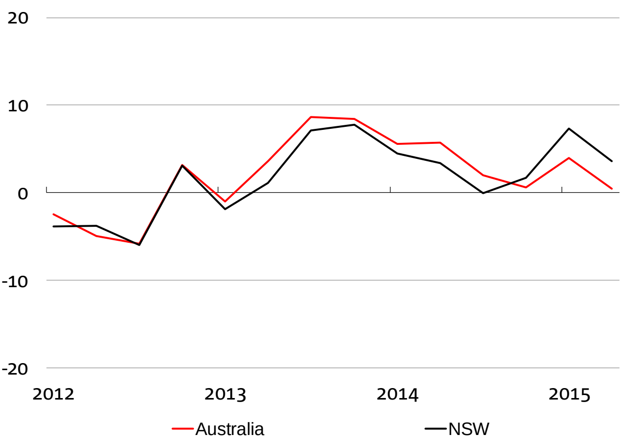
Business conditions by state (net balance)

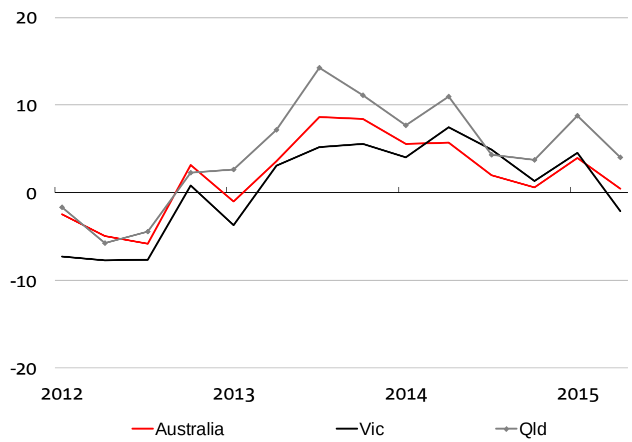


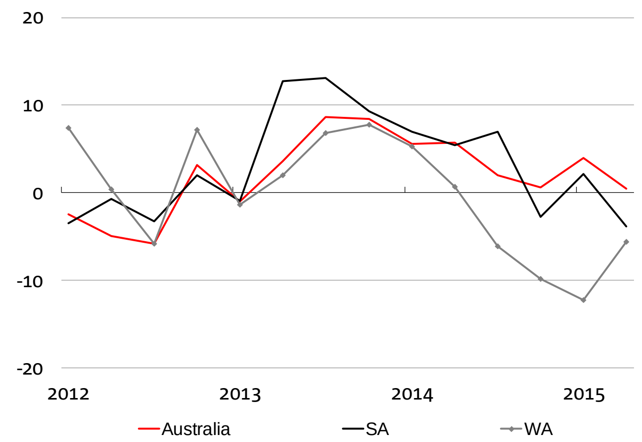




Business confidence by state (net balance)







Data appendix

	Quarterly					Monthly				
	2014q3	2014q4	2015q1	2015q2	**2015q3**	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Confidence	6	2	1	4	**0**	7	8	4	1	5
Conditions	4	4	3	5	**11**	7	10	6	9	9

	Quarterly					Monthly				
	2014q3	2014q4	2015q1	2015q2	**2015q3**	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Trading	8	9	8	11	**18**	13	18	12	19	15
Profitability	3	5	2	4	**11**	9	11	9	10	8
Employment	-1	0	0	-1	**1**	-1	1	-1	-1	4

	Quarterly[(a)]					Monthly				
	2015q1	2015q2	2015q3	2016q2	2016q3	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Conditions	5	**11**				7	10	6	9	9
Conds. next 3m	8	10	**13**							
Conds. nxt 12m	24	25	22	19	**25**					
Orders	1	**5**				3	5	3	5	3
Orders next 3m	7	6	**8**							

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

	Quarterly[(a)]					Monthly				
	2014q3	2014q4	2015q1	2015q2	**2015q3**	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Capacity utilis.	80.4	80.9	80.8	**80.9**		80.9	81.3	80.9	81.2	81.3
Stocks current	1	1	0	**2**		1	-1	2	1	0
Stocks next 3m	-1	-2	-4	-1	**0**					

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

Constraints on output (% of firms)*	2014q3	2015q2	2015q3
Sales & orders	53.7	53.9	**53.2**
Labour	34.4	33.5	**37.1**
Premises & plant	18.9	19.2	**19.5**
Materials	8.7	10.6	**9.1**

Main constraints on profitability (% of firms)*	2014q3	2015q2	2015q3
Interest rates	3.1	2.5	**2.5**
Wage costs	11.8	12.0	**11.7**
Labour	5.3	4.4	**5.6**
Capital	2.5	2.0	**1.7**
Demand	49.9	51.5	**51.5**
All other	27.4	27.6	**27.0**

** not s.a.*

Data appendix (cont.)

	Quarterly [(a)]					*Monthly*				
	2015q1	2015q2	2015q3	2016q2	2016q3	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Empl current	-1	**1**				-1	1	-1	-1	4
Empl next 3m	0	0	**4**							
Empl nxt 12m	7	10	7	7	**11**					

(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	2.3	2.7	3.2	2.3	2.4	2.5	2.8	2.6	2.7
Productivity offset	0.7	1.1	0.7	0.9	0.8	0.6	0.7	0.6	0.8
Net EBA growth	1.6	1.6	2.5	1.3	1.6	1.9	2.1	1.9	1.9

State Tables

	Quarterly					*Monthly*				
	2014q3	2014q4	2015q1	2015q2	**2015q3**	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Business conditions										
NSW	7	8	10	12	**18**	14	13	10	21	12
VIC	4	6	9	10	**15**	11	17	16	13	11
QLD	-5	-1	-5	-5	**2**	-3	1	2	3	0
SA	-2	5	-12	-11	**-3**	-11	2	-11	-3	0
WA	4	4	-5	-2	**-4**	9	5	1	-2	16

	Quarterly					*Monthly*				
	2014q3	2014q4	2015q1	2015q2	**2015q3**	2015m05	2015m06	**2015m07**	**2015m08**	**2015m09**
Business confidence										
NSW	3	0	2	7	**4**	12	10	4	4	4
VIC	7	5	1	5	**-2**	8	7	4	0	-1
QLD	11	4	4	9	**4**	10	7	10	4	6
SA	5	7	-3	2	**-4**	6	4	-4	-4	17
WA	1	-6	-10	-12	**-6**	-7	9	1	-13	2

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