

NAB Monthly Business Survey

by NAB Group Economics

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October 2015



Key Points:

- **Business conditions were unchanged at an above average +9 index points** in October, again consistent with the theme of recovery in non-mining sectors of the economy. By component, **employment** conditions maintained the improvement recorded last month, while **trading conditions** improved modestly and **profitability** eased – although both of these remain at very elevated levels. **Service sectors continue to report more favourable conditions** than other industries, despite a pull-back in personal services during the month, while mining, manufacturing and wholesale were all negative. **Capacity utilisation** increased further this month, which bodes well for business investment and the labour market. But despite solid conditions, **forward orders have weakened** (turning negative in the month), raising the risk of a softening in activity in the very near term.
- **Business confidence remains somewhat fickle**, despite persistent strength in business conditions. The confidence index eased back in the month, unwinding much of the gain following the Government's leadership resolution and a paring-back of concerns about emerging markets. Nevertheless, confidence remained positive (at +2) – albeit still well below the long run average – and was unchanged in trend terms (+3). **The deterioration was reasonably broad based**, with only finance/ property/ business, manufacturing and mining improving (although mining remains negative).
- **The business survey still points to a reasonably resilient recovery in the non-mining sector, despite stubbornly sluggish business confidence in the past six months.** Better business conditions are not being felt uniformly across the economy, as industries that are better positioned to benefit from lower interest rates (especially those closely tied to residential real estate) and the AUD remain the clear outperformers – personal and business services are the main standouts. Despite a number of downside risks (mostly stemming from offshore), should non-mining sectors continue to improve, we maintain the view that further RBA cuts are unlikely. Monetary policy is expected to remain on hold for an extended period, although the timing of the first hike has been pushed out till mid-2017.

Table 1: Key monthly business statistics*

	Aug 2015	Sep 2015	Oct 2015		Aug 2015	Sep 2015	Oct 2015	Contents
	<i>Net balance</i>				<i>Net balance</i>			
Business confidence	1	5	2	Employment	-1	3	3	Key points 1
Business conditions	10	9	9	Forward orders	5	3	-2	Analysis 2
Trading	18	15	16	Stocks	1	0	0	Other activity indicators 3
Profitability	11	9	8	Exports	3	0	1	Implications for forecasts 4
	<i>% change at quarterly rate</i>				<i>% change at quarterly rate</i>			
Labour costs	0.6	0.6	0.3	Retail prices	0.7	1.1	0.5	Costs & prices 5
Purchase costs	0.8	0.9	0.9		<i>Per cent</i>			
Final products prices	0.3	0.3	0.3	Capacity utilisation rate	81.2	81.3	81.4	More details 6

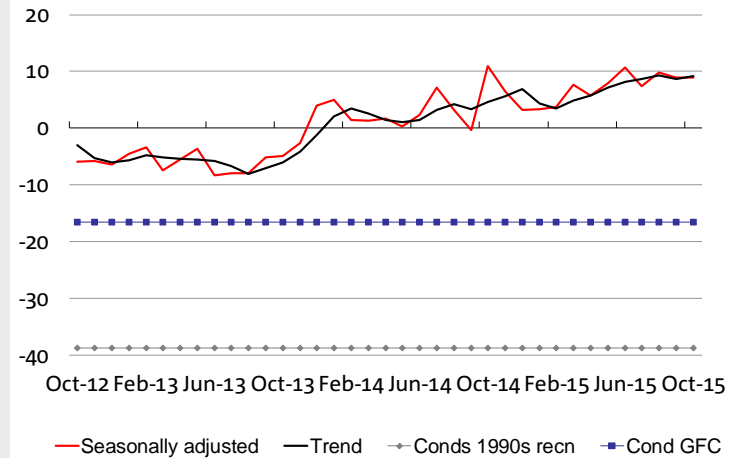
* All data seasonally adjusted and subject to revision. Cost and prices data are monthly percentage changes expressed at a quarterly rate. Fieldwork for this survey was conducted from 26 Oct to 30 Oct, covering over 400 firms across the non-farm business sector.

Analysis

- Business conditions** remain encouragingly robust, maintaining the solid gains obtained over the past year despite less than impressive levels of business confidence. The business conditions index was unchanged in October, at +9 index points, which was well above the long-run average of +5 and the post-GFC average of around +2. Consistently above-average outcomes (since March) are helping to provide reassurance that the non-mining economic recovery is gaining further traction, although there continues to be a significant dispersion in business conditions across industries. By component, the **employment index** sustained the gains recorded last month, which pushed the index back into positive territory. This outcome is more in line with the solid outcomes for other labour market partials. Both **trading and profitability** remain at very elevated levels, although profitability eased modestly in the month, while trading conditions improved slightly.
- The **notable dispersion in business conditions across industries continued into October**, with 3 of the 8 major industry groups (mining, manufacturing and wholesale) reporting negative conditions. **Services industries continue to outperform**, while the mining industry trails well behind. A majority of industries improved in the month, but recreation & personal services and construction both saw sizable falls in their conditions index. If sustained, the dispersion in conditions could potentially pose a hindrance to the non-mining recovery, although for now it most likely reflects varying sensitivity across industries to the lower AUD and interest rates which should diminish over time.
- Business confidence** has been stubbornly sluggish in the past six months, despite solid business conditions, with the index dropping back to +2 index points in October – a positive result, but still well below the long run average. Last month’s bounce was short-lived. While the Government’s leadership resolution appeared to have a notable (albeit temporary) effect, it is difficult to disentangle this from concerns about growth in emerging markets and financial market volatility which is likely to have influenced confidence with varying degrees of intensity in recent months. The recent drop in forward orders may also have weighed on confidence this month.
- The drop in confidence was somewhat broad based**, although mining, manufacturing and finance/ property/ business improved (yet mining confidence remains very weak). The deterioration was largely in transport/utilities (down 14) and recreation & personal services (down 11). Service industries (personal and business services) enjoyed the highest confidence levels (both at +5 points), while mining firms were least confident (at -14).
- There was a notable deterioration in both conditions and confidence in WA, consistent with ongoing drag from mining – confidence also fell considerably in SA. In contrast, Qld recorded sizable improvements in the month (especially in business conditions). Looking through the monthly volatility, conditions were still strongest in NSW and Victoria (of the mainland states). Business confidence showed similar trends, although Queensland remains the highest of the mainland states (in trend terms).

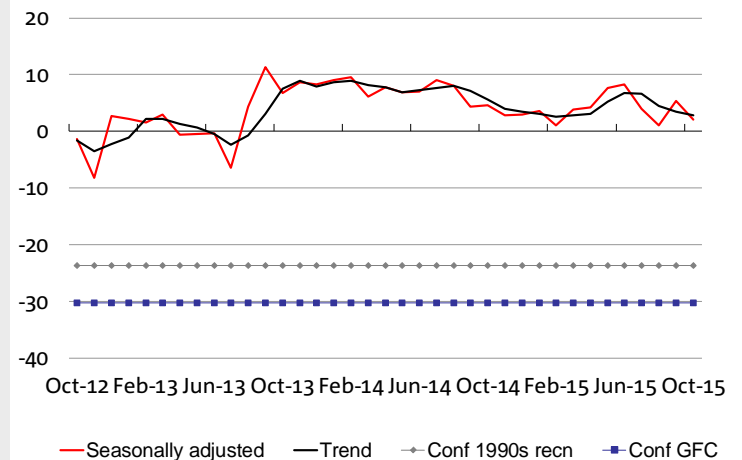
Conditions steady and solid levels

Business Conditions (net balance)



Bounce in confidence was short lived

Business Confidence (net balance)



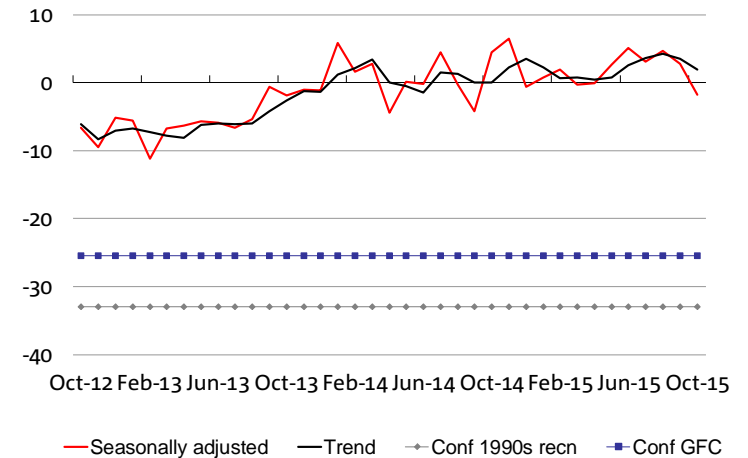
Excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next month to change?

Other activity indicators

- The **forward orders** index eased further in October, down to -2 index points, from +3 in September and a recent high of +5 (in August). This is below the long run average of the series, and is the first time the index has fallen into negative territory (rounded) since the end of 2014. The implication for near-term activity could partly explain presently soft levels of business confidence – despite relatively elevated conditions. The decline in orders was relatively broad-based, although retail and finance/ property/ business services experience the brunt of the deterioration (down 18 and 10 points respectively). In contrast, mining and transport were the only industries to improve, although mining orders remain very weak. Orders are still strongest in construction (+12), suggesting that strength in residential construction may be helping to offset sharp falls in mining engineering construction. In contrast, the orders index was weakest in retail (-13), followed by mining (-12) and wholesale (-10). In trend terms, however, retail has held up better and mining is weakest (-14). Construction is highest (+15) in trend terms, followed by transport/utilities (at +7).
- Consistent with the elevated level of trading conditions, capacity utilisation rose modestly in the month to 81.4% (from 81.3%), its highest rate since early 2012. Although capacity utilisation is still below pre-GFC highs, the trend continues to show improvement, which provides some optimism on the outlook for non-mining business investment and the labour market. However, utilisation rates relative to long run averages vary considerably across industries, with more than half below their respective long run averages. Additionally, capacity utilisation only increased in mining (up 1 ppt) and construction (up 0.7 ppts), which more than offset declines in all other industries – transport & utilities was down the most (falling 1.8 ppts).
- The capital expenditure index was slightly lower in October at +6 index points – which is still above its long-run average level (+5). The trend index was unchanged at +7 index points, close to its post-GFC high. This points to a stronger expansion of non-mining business investment (which has a higher weighting in the survey) than ABS data currently indicate. Trend recreation & personal services capex is the highest (+16 points) and mining is the lowest (-9 points). Transport & Utilities was the only other industry group to record a negative capex index in trend terms, at -4 points.
- Elsewhere in the survey, cash flow (not seasonally adjusted) was the strongest in finance/ property/ business services, and the weakest in wholesale. The construction cash flow index also turned negative.

Sales orders ease, and are subdued

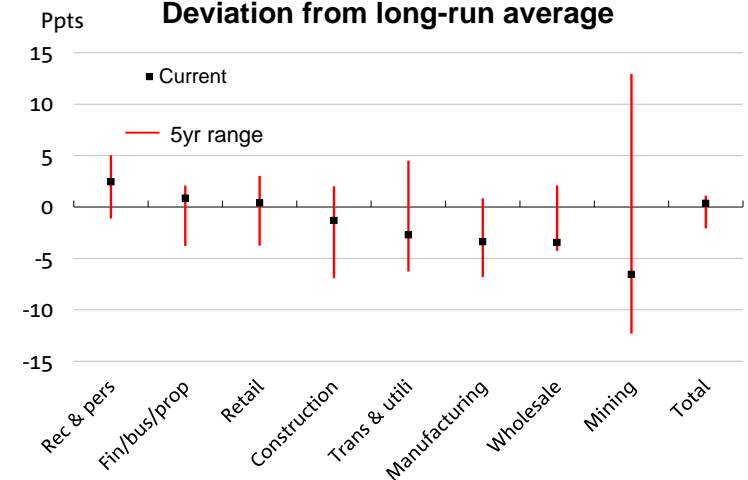
Forward Orders (net balance)



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

Capacity utilisation by industry

Deviation from long-run average

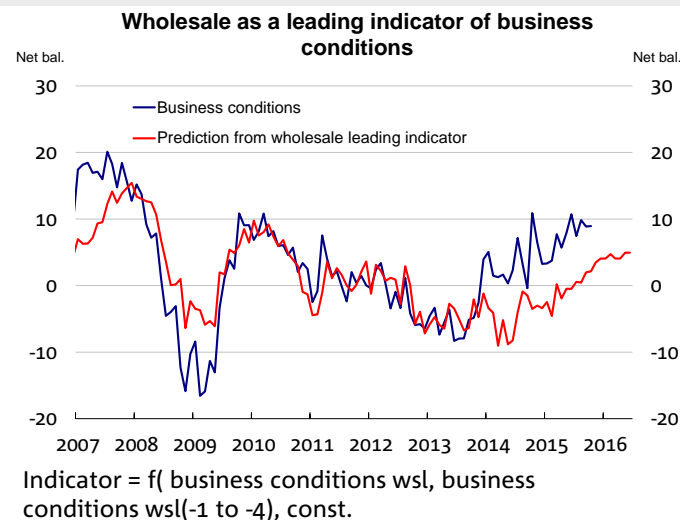
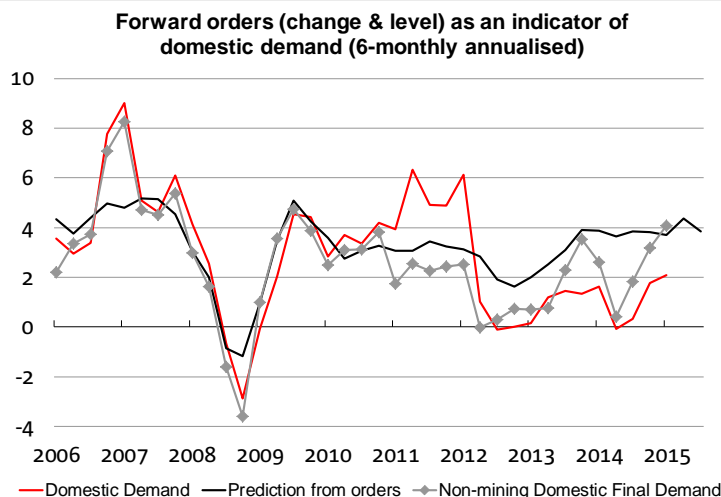


Source: NAB Economics

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

Implications for forecasts For more information see latest [Global & Australian Forecasts](#)

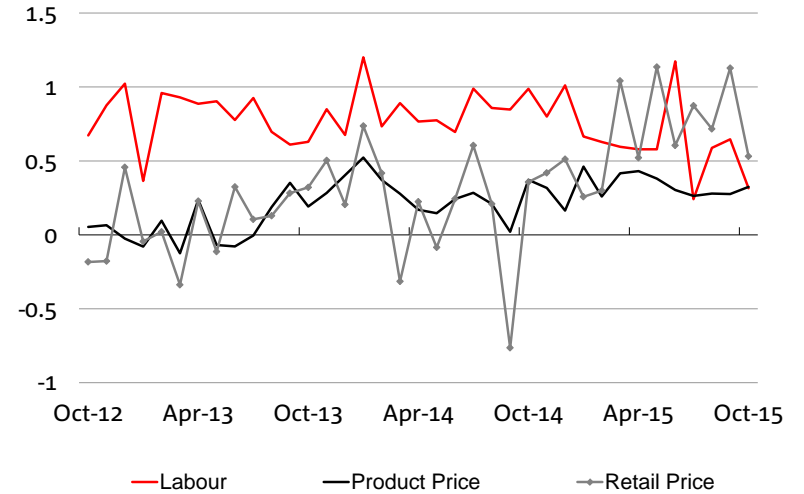
- Although some of the risks hanging over global markets have abated, recent and forecast global economic growth remains lacklustre. Growth remains stuck in the 3 to 3¼% range seen since mid-2012 as lower commodity prices, capital flow reversals and central banks focused on getting inflation back toward target take a toll on the pace of expansion in emerging market economies that underpin most global output expansion. Growth should level out in the US and UK at a moderate 2 to 2½% pace and pick up slightly in the poorly performing Euro-zone and Japanese economies but this is not enough to fundamentally change a global outlook that remains dominated by the loss of momentum in the emerging economies. Inflation is low in the big advanced economies, allowing central banks to take a cautious and gradual approach to lifting interest rates to “normal” levels - but inflation is still a problem in some emerging economies.
- In Australia, we remain of the view that the gradual recovery in the non-mining sector is gaining traction. Recent outcomes from the business survey support this contention, while the unemployment rate is holding steady. In addition, partial indicators for Q3 GDP suggest a high outcome, which would retrace the temporary weakness in Q2. The RBA appears to concur with this assessment, and chose to hold off further monetary policy easing in the month despite some tightening of financial conditions. Low inflation however does provide room for the RBA to ease, although this would require evidence that local demand conditions are deteriorating again (not our or the RBA’s central case scenario), and more concrete evidence that housing demand is easing. As such the RBA is expected to remain on hold for an extended period, although we have pushed out the timing of the first hike until mid-17. Real GDP is forecast to expand by 2.6% in 2015/16 and 3.0% in 2016/17, with El Niño only subtracting marginally. The unemployment rate eases gradually but remains elevated for an extended period.
- Our model of 6-monthly annualised demand growth, using forward orders as a predictor, has continued to suggest stronger growth than the National Accounts. This divergence can be partly explained by the greater representation of non-mining sectors in the business survey – headline growth in the National Accounts has masked recent improvements in non-mining domestic demand. Nevertheless, applying trend forward orders from October to our model suggests that predicted domestic demand growth for Q3 and Q4 could be a little stronger than in Q2.
- Business conditions derived from our ‘wholesale leading indicator’ (below), which has previously had a good leading relationship with economic activity, would imply a somewhat weaker business environment than the headline index suggest – although this could reflect margin squeeze from AUD depreciation given the difficulty passing on additional costs to retailers and final consumers.



Costs, prices & labour

- Labour costs growth (a wages bill measure) decelerated slightly in the month (down 0.3 ppts), to be at very subdued levels – at 0.3% (a quarterly rate). Subdued labour cost growth is consistent with the currently elevated rate of unemployment and relatively subdued inflation expectations – although labour market partials have generally become more positive. Labour cost inflation decelerated the most in construction (down 0.6 ppts), although the rate of growth remains positive (albeit subdued, at 0.3%). In contrast, wages growth accelerated the most in mining (up 0.8 ppts), following a sharp deceleration the previous months. Transport & utilities was the only other industry to see labour cost growth accelerate, up 0.1%. ABS data on the labour market showed trend employment increasing by 12,400 jobs in September, but while the pace of job creation has slowed, the unemployment rate has steadied at 6.2%. The NAB Survey’s employment index, however, is pointing to stronger momentum in the coming 6 months – suggesting annual job creation of around 200k (nearly 17k per month). NAB’s measure of employment conditions managing to hold on to last months gains (at +3 index points), which is its equal highest level since 2011. There was, however, significant variation in employment conditions across industries in the month. Mining fell sharply (down 13), while transport (down 7), manufacturing (down 5) and construction (down 2) also weakened. In contrast, wholesale increased the most (up 5), followed by recreation services (up 3). The employment index is very negative for mining (-24 points), while service industries (including retail) are reporting the strongest employment demand.
- Growth in purchase costs was unchanged at 0.9% in October (at a quarterly rate), which is in line with the long-run average and above the average rate seen since the GFC. Trend acceleration could suggest increased pass-through from a lower AUD – although the response to AUD movements to date has been relatively muted. Growth in purchase costs accelerated the most in construction (up 0.3 ppts), but surprisingly it eased notably in wholesale (down 1.4 ppts) – although this industry is still reporting the highest rate of growth.
- Final product prices growth was unchanged in October at a quarterly rate of 0.3%. This could imply that firms are continuing to find it difficult to pass on higher purchase costs to the end consumer – consistent with recent easing in profitability. Changes in prices growth were again mixed across industries, with the greatest pick-up occurring in construction and recreation services (both up 0.3 ppts), although product inflation remains highest in wholesale (1.1%). The decline in mining prices accelerated in the month (down 1 ppt to -1.7%) – consistent with a decline in non-rural commodity prices in October. Final retail prices growth dropped (down 0.6 ppts to 0.5%), pointing to moderate inflation pressure.

Price pressures eased in the month
Costs & prices (% change at a quarterly rate)



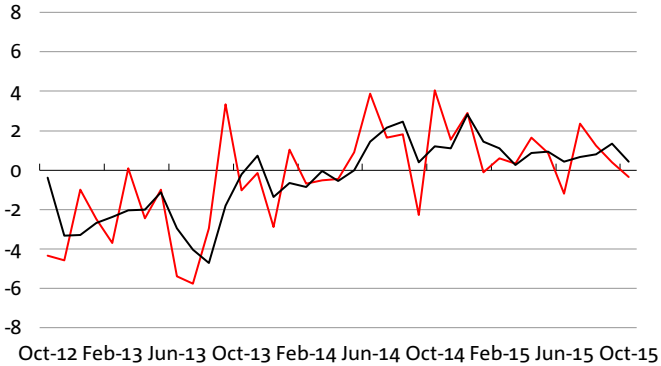
Based on respondent estimates of changes in labour costs and product prices. Retail prices are based on retail sector product price estimates.



More details on business activity

Firms reluctant to re-stock

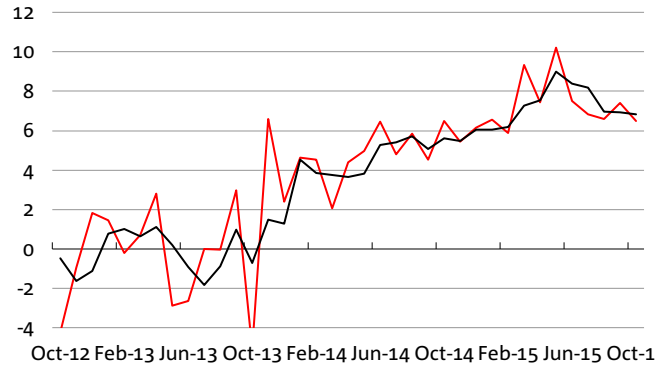
Stocks (net balance)



— Seasonally adjusted — Trend

Capex momentum may have stalled, but at solid levels

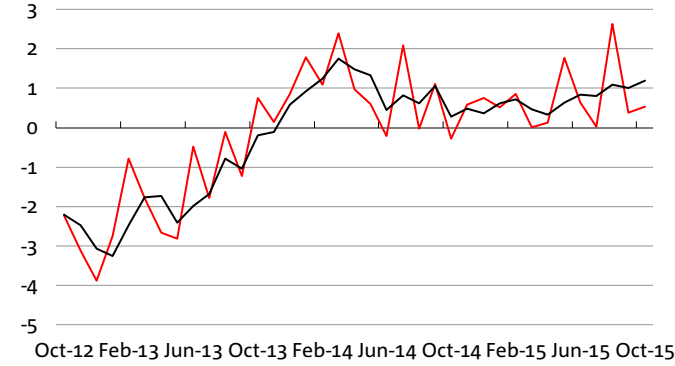
Capital Expenditure (net balance)



— Seasonally adjusted — Trend

Exports soft despite AUD assistance

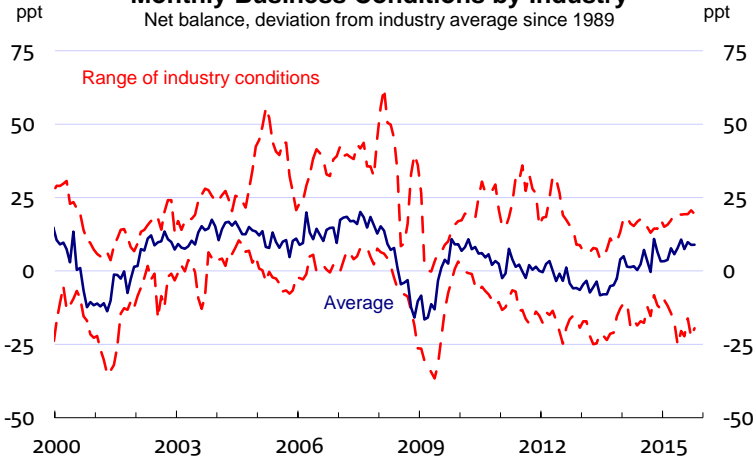
Exports (net balance)



— Seasonally adjusted — Trend

Range of conditions remains wide, due to weak mining/strong services

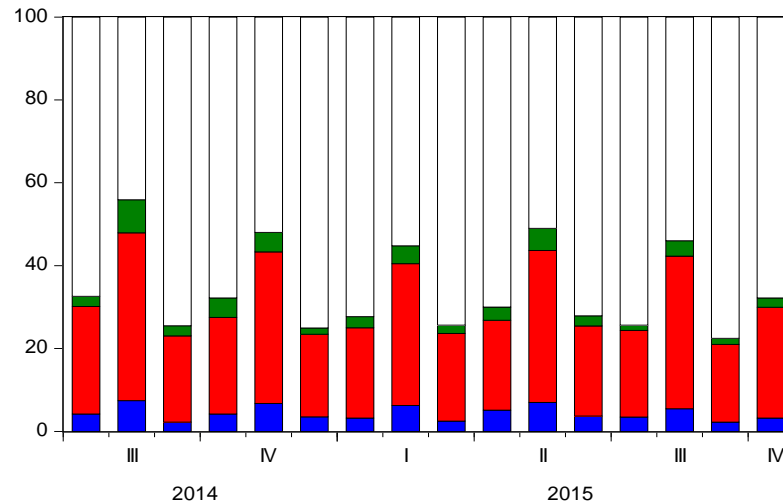
Monthly Business Conditions by Industry
Net balance, deviation from industry average since 1989



Source: NAB

Borrowing conditions improved in past 3 months, and demand for credit rose

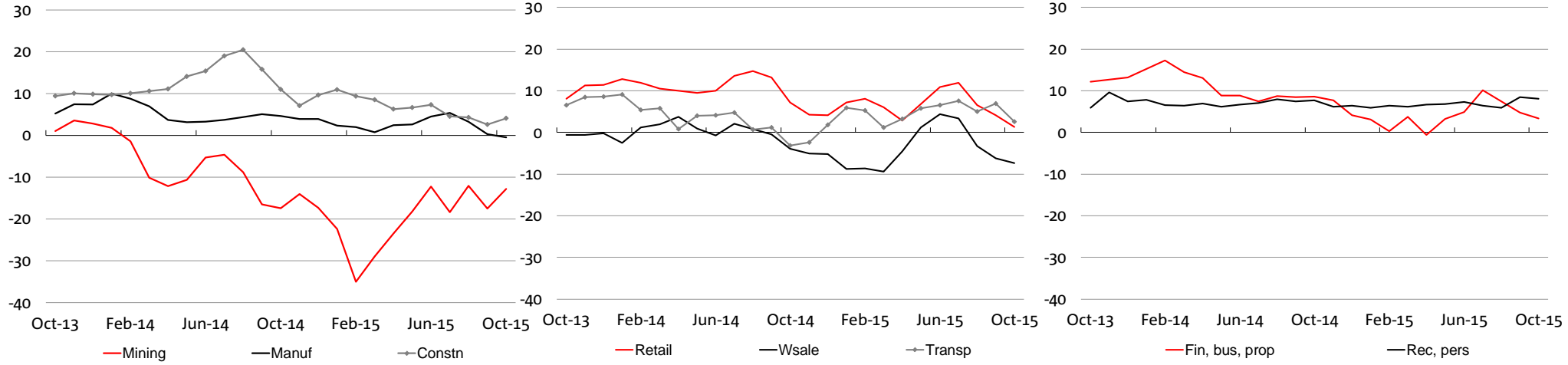
Borrowing conditions (% of firms)



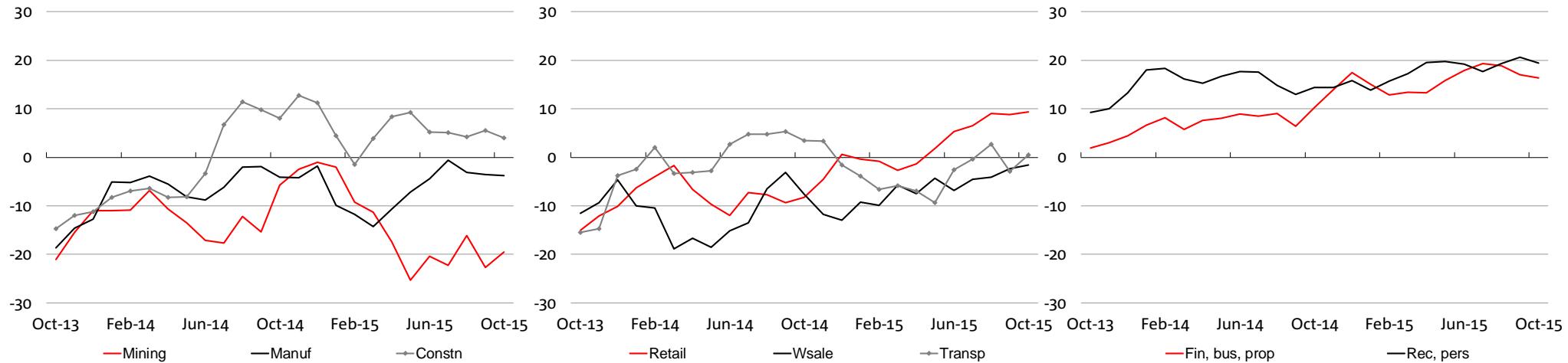
■ More difficult ■ Unchanged ■ Easier □ No borrowing required

More details on industries

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

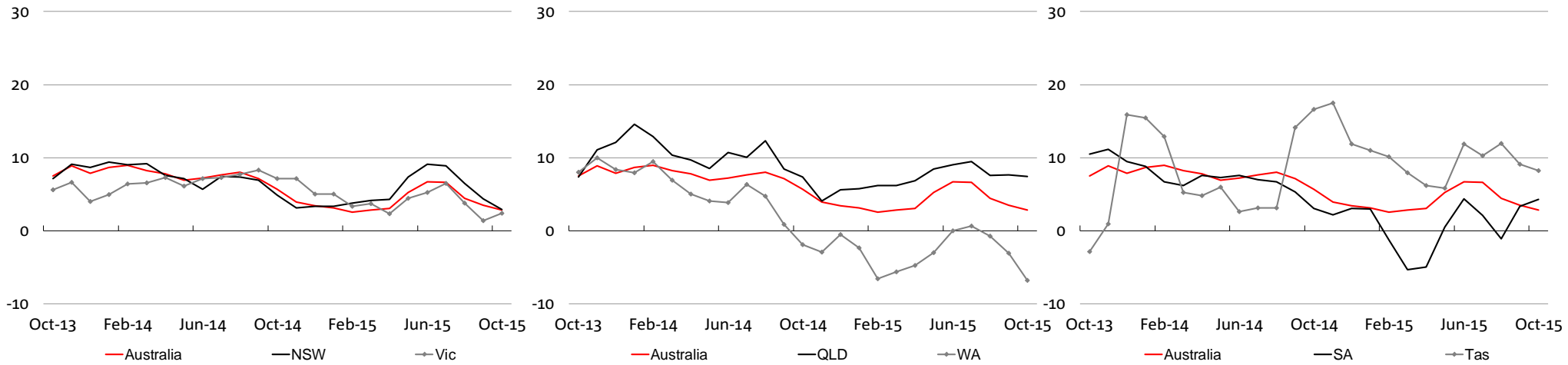


Business conditions by industry (net balance): 3-month moving average

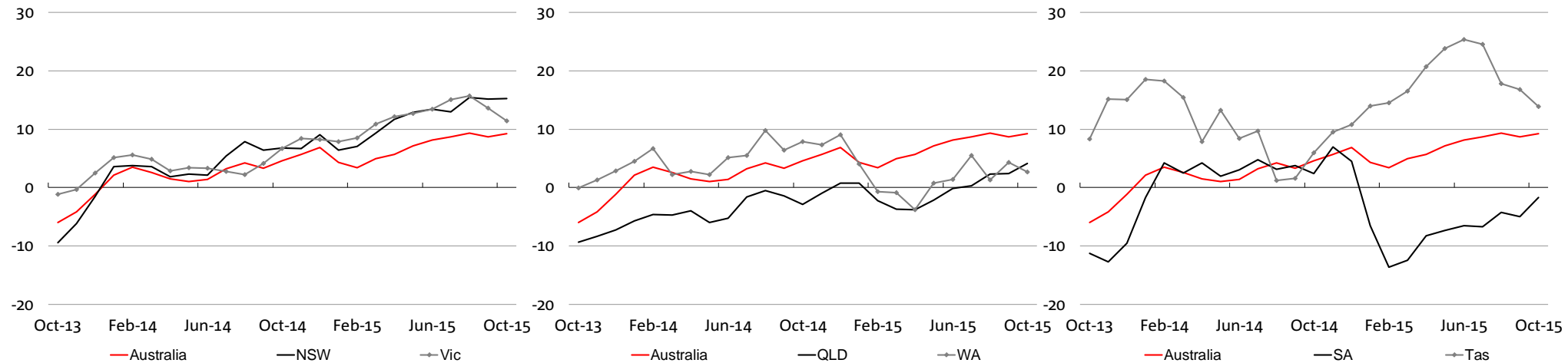


More details on states

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



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



Data appendix

Prices & costs by industry (% change at a quarterly rate)

Oct-2015	Mining	Manuf	Constn	Retail	Wsale	Tran. & utils	Rec. & pers.	Fin. prop. & bus.	Australia
Labour costs: current	-2.3	0.3	0.3	0.3	0.0	0.8	0.9	0.2	0.3
Labour costs: previous	-3.1	0.5	0.9	0.7	0.1	0.7	1.0	0.3	0.6
Labour costs: change	0.8	-0.2	-0.6	-0.4	-0.1	0.1	-0.1	-0.1	-0.3
Prices (final): current	-1.7	0.3	0.1	0.5	1.1	0.4	0.6	0.1	0.3
Prices (final): previous	-0.7	0.1	-0.2	1.1	1.4	0.5	0.3	-0.1	0.3
Prices (final): change	-1.0	0.2	0.3	-0.6	-0.3	-0.1	0.3	0.2	0.0
Purchase costs: current	-0.4	1.5	0.1	1.4	1.9	0.3	0.9	0.3	0.9
Purchase costs: previous	-0.4	1.5	-0.2	2.3	3.3	0.7	0.7	0.2	0.9
Purchase costs: change	0.0	0.0	0.3	-0.9	-1.4	-0.4	0.2	0.1	0.0

Key state business statistics for the month

Oct-2015	Monthly Business Survey Data: By State						
	NSW	VIC	Qld	SA	WA	Tasmania	Australia
Bus. conf.: current	0	7	10	-1	-10	0	2
Bus. conf.: previous	4	0	8	17	1	11	5
Bus. conf.: change	-4	7	2	-18	-11	-11	-3
Bus. conf: current - Trend	3	2	7	4	-7	8	3
Bus. conf: previous Trend	4	1	8	3	-3	9	3
Bus. conf.: change -Trend	-1	1	-1	1	-4	-1	0
Bus. conds: current	11	10	8	-1	-4	21	9
Bus. conds: previous	13	11	1	0	15	13	9
Bus. conds: change	-2	-1	7	-1	-19	8	0
Bus. conds: current -Trend	15	11	4	-2	3	14	9
Bus. conds: previous -Trend	15	14	2	-5	4	17	9
Bus. conds: change -Trend	0	-3	2	3	-1	-3	0

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