

NAB MULTINATIONAL BUSINESS SURVEY

December Quarter 2016 (Embargoed until 11.30am Tuesday 14th March)

By Group Economics



FOREIGN OWNED MULTINATIONALS ENJOY STRONG CONDITIONS IN THEIR AUSTRALIAN OPERATIONS. OF THOSE FIRMS, MULTINATIONALS OPERATING IN NSW ARE A CLEAR STANDOUT

NAB Economics have partnered with NSW Trade and Investment in utilising the NAB Quarterly Business Survey (QBS) to gain a better understanding of foreign multinationals operating in Australia, and especially NSW. Commencing from the December quarter 2016, the NAB QBS asked firms an additional question on the location of their parent company (if they have one; definitions on p5). That has allowed us to single out the performance of foreign multinationals operating within Australian borders, based on the numerous metrics available from the Survey. Attempts are currently underway to extrapolate a time series of business indicators for these firms, but for now available outcomes are restricted to Q4 2016.

In the final quarter of 2016, the NAB Multinational Business Survey revealed that **business conditions** – a composite of trading/sales conditions, profitability and employment – were strong for foreign multinationals, at +13 index points, and were higher than for those with an Australian-based headquarters (although conditions were quite positive despite ownership) (Chart 1, Table 1). Given the importance of attracting foreign investment to the local economy, it is encouraging to see that foreign multinationals already operating within Australia are performing so well – and are especially strong in NSW (see below). **Business confidence** on the other hand is looking more balanced, at reasonably positive levels (+6 index points for all ownership types).

By component, foreign multinationals are reporting very good sales activity, with our trading conditions index at 20 points, which was well above the (also solid) levels seen by other firms. Reflecting the apparently strong demand conditions, profitability was also quite high, at 15 index points, which was again higher than that reported by other firms. Employment conditions, however, were a little less encouraging (albeit still positive). The employment conditions index meanwhile was at +3 index points, which is slightly below the level recorded by firms with headquarters located within Australia.

Concentrating on NSW, foreign multinationals reported very strong business conditions in Q4 2016 (+16 points), albeit slightly lower than for firms with an Australian-owned headquarters (Charts 2). By component, foreign multinationals saw the best trading conditions, but were noticeably softer on employment conditions relative to other firms in NSW. They also performed better in NSW than in other states (Chart 3), outperforming in two out of three components (employment again being the exception).

Chart 1: Key results from the Survey

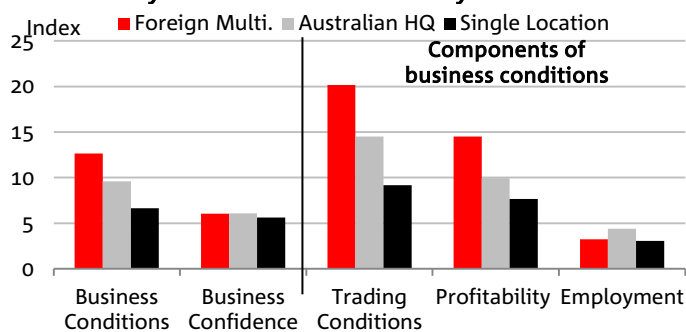


Table 1: Key results from the Survey

	Australian HQ	Single Location	Foreign Multi.	Total
Business Conditions	10	7	13	9
Business Confidence	6	6	6	6
Trading Conditions	15	9	20	14
Profitability	10	8	15	10
Employment	4	3	3	4

Chart 2: Key results for NSW firms

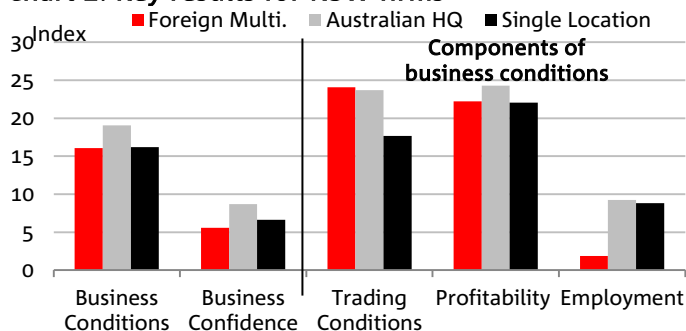


Chart 3: Foreign multinationals (NSW vs other states)

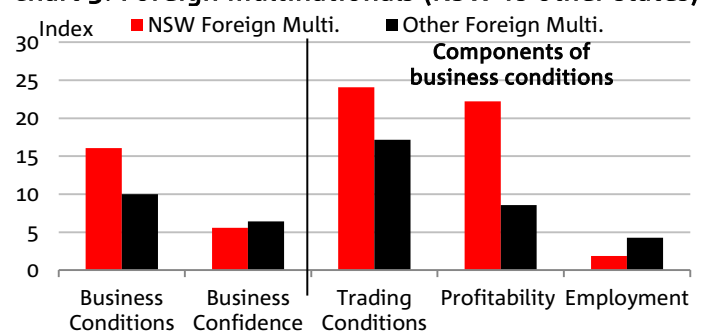
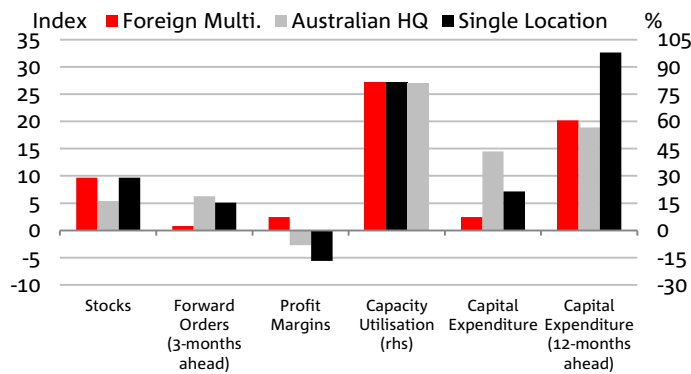


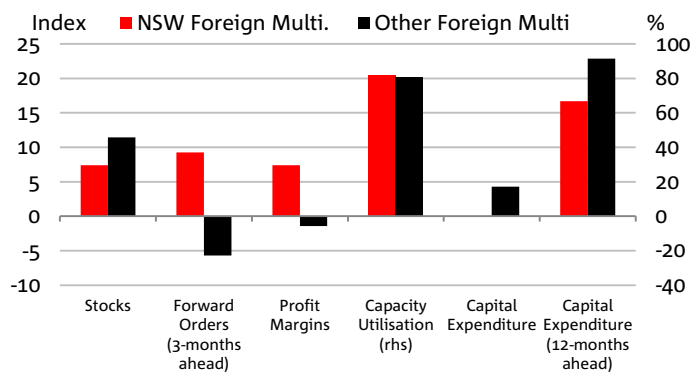
Chart 4: Other key indicators (Australia)



OTHER KEY INDICATORS

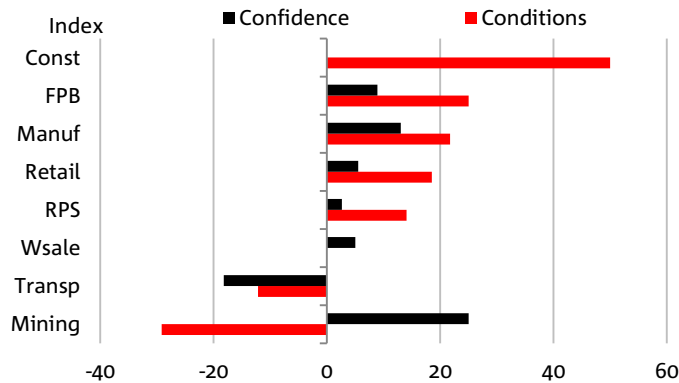
The outperformance of business conditions for foreign multinationals at the national level is not quite replicated across all the other key financial and forward indicators from the Survey (Chart 4). They are, however, leading when it comes to profit margins, which suggests that these firms are experiencing a relatively favourable business environment, both in terms of costs and revenue. That would tend to suggest that the positive inventory index points to voluntary restocking by firms – although that seems counter to forward orders, which are noticeably lower for foreign multinationals than for other firms. Capacity utilisation outcomes suggest similar levels of spare capacity, regardless of ownership, but investment activity by foreign multinationals appears relatively lower, while their intentions to invest in the next 12 months are significantly lower than for some other firms (more details below).

Chart 5: Other key indicators (NSW FO firms v Other state FO firms)



Focussing on NSW, foreign multinationals are performing better than in other states on a number of measures, including profit margins and forward orders (Chart 5). However, the investment outlook is perhaps not quite as encouraging as it is in other states – despite foreign multinationals enjoying much better demand conditions (business conditions and forward orders) in NSW than elsewhere.

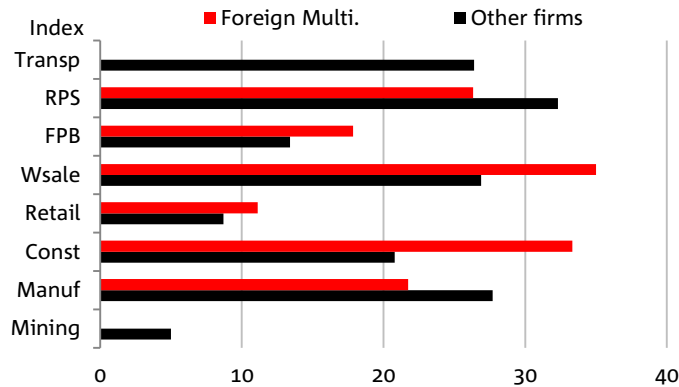
Chart 6: Business conditions and confidence for foreign multinationals, by industry*



KEY RESULTS BY INDUSTRY

The sample from the Business Survey allows us to deconstruct responses by industry, at the national level. On balance, foreign multinationals within the construction industry experienced the best business conditions in Q4 2016, while conditions in the mining industry look extremely poor (Chart 6). That said, mining confidence was a clear standout in the quarter, which probably reflects improvements in project viability due to a rally in commodity prices. Transport was the only other industry where foreign multinationals reported negative business conditions (and even weaker confidence). While that may partly reflect mixed conditions in distributional services more generally, higher energy costs are probably contributing to the weak result. Unsurprisingly, foreign multinationals in services industries have performed relatively well, which is a trend reflected in the broader economy. Solid conditions in retail are also encouraging given mixed indications from other data sources.

Chart 7: Capital expenditure intentions – next 12 months*



Similar to domestically-owned firms, foreign multinationals are reporting capital expenditure intentions that vary significantly across industries (Chart 7). Foreign multinationals appear more keen to invest than other firms in wholesale, construction, retail, and professional services. Construction is unsurprising given the strength of the residential boom, but the high level for wholesale (and to some extent manufacturing) is interesting given the significant structural changes underway within the industry. Investment intentions are also high for personal services (RPS), just not as high as locally-owned business.

* Some industries reflect only a small sample size; there were zero responses for mining firms operating from one location in Australia.

Chart 8: Expectation indicators (next 12-months)

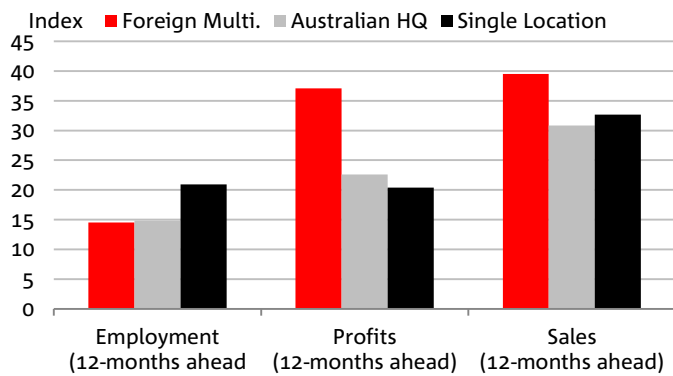


Chart 9: Expectation indicators (next 12-months, NSW FO Firms)

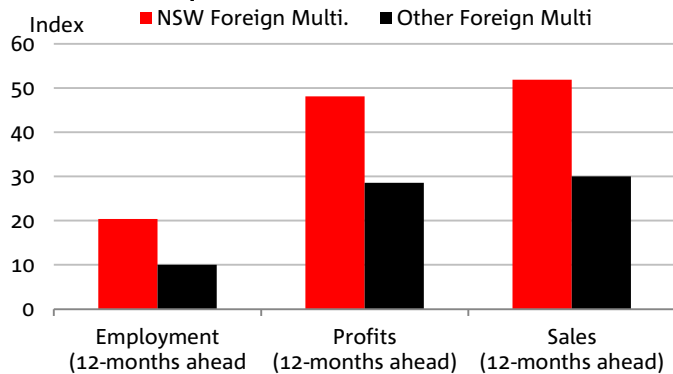


Chart 10: Borrowing conditions & required returns for foreign multinationals

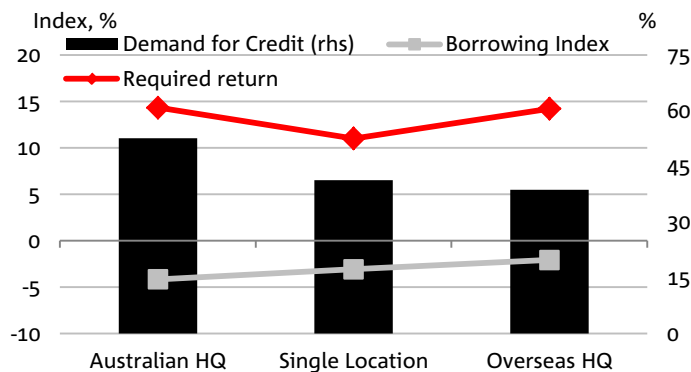
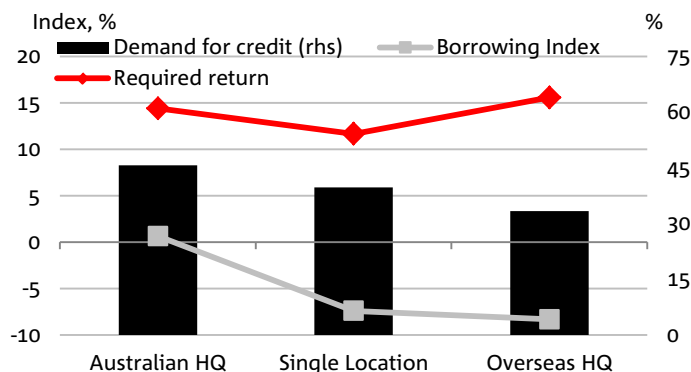


Chart 11: Borrowing conditions & required returns for foreign multinationals (NSW)



OTHER INDICATORS OF BUSINESS EXPECTATIONS

Aside from capital expenditure expectations, the Survey also asks firms about their outlook for factors such as sales, profits and employment. On balance, foreign multinationals are noticeably more upbeat on their 12-month outlook for sales and profits than they are for employment (Chart 8). This might normally suggest that firms are looking to undertake a more capital intensive expansion of their operations, and/or reduce spare capacity, but also in this instance is hard to square away with current levels of capacity utilisation and capex expectations (discussed above). Therefore, this outcome may point to an anticipated improvement in efficiency/productivity?

In terms of the outlook for foreign multinationals operating in NSW, these firms tended to point to a better outlook for the next 12 months than foreign multinationals in other states. Sales, profit and employment expectations (12-months ahead) were all higher for these firms (Chart 9). Once again, employment conditions are lagging behind, although the net balance is still quite positive at +20 index points.

BORROWING & REQUIRED RETURNS

To get a better idea of what is affecting decisions on capital expenditure, the Survey asks about credit conditions and the required rate of return for potential investments. On credit demand, the Survey shows that foreign multinationals tended to require less borrowing in the quarter than other types of firms (Chart 10, black bars). A similar observation can be made for foreign multinationals operating in NSW (Chart 11, black bars).

The lower demand for credit could reflect a number of potential factors. Perhaps foreign multinationals have greater access to other sources of finance. Another possibility is that foreign multinationals are still more reluctant to take on debt than solely domestic firms, given the higher degree of disruption in foreign debt markets over recent years. Overall borrowing conditions (i.e. supply side constraints) might be another factor that is limiting firms borrowing. Differences in regulation and risk assessment can affect the willingness of banks to lend to foreign firms relative to solely domestic ones. To measure this, the Survey produces a borrowing index, which compares those firms who found it easier to borrow versus those who found it harder. Interestingly, at the national level, foreign multinationals found it no harder than other firms to borrow, but they did find it harder in NSW (Charts 9 & 10, grey lines).

Finally, required rates of return on investment appear to be a little higher for foreign multinationals, which could be a limiting factor on capex given the uncertain growth outlook for the economy (Charts 10 & 11, red lines).

Chart 12: Constraints on output for foreign multinationals

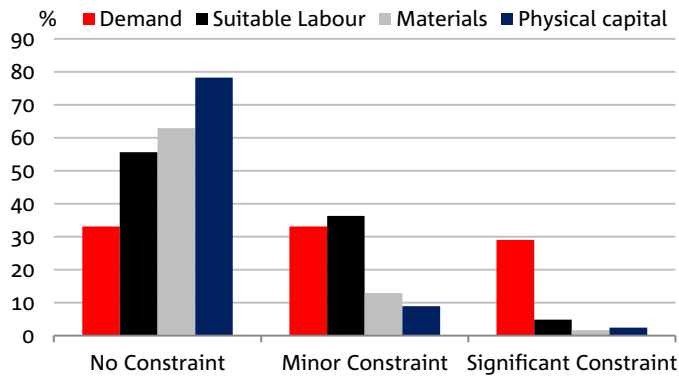
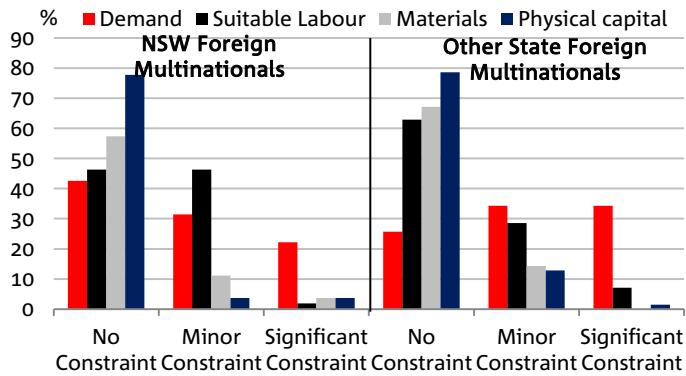


Chart 13: Constraints on output for NSW foreign multinationals



CONSTRAINTS ON BUSINESS OUTPUT

When asked about the main constraints on the firm’s output, aggregate demand tends to be the most common response. Foreign multinationals are no different, with more than half of these firms indicating that demand was either a minor or major constraint on their output (Chart 13, red bars). However, a significant proportion of foreign multinationals (more than a third), also indicated that a lack of suitable labour is playing a role as well. Given that the unemployment rate is elevated in Australia (5.8%), and the underemployment rate is close to record highs, there certainly seems to be an adequate supply of workers in the market. Therefore, this result could suggest that firms consider the available workers to be underqualified, inexperienced or not qualified in the skills that are required. The availability of materials and physical capital is much less of a concern, but around 10% of foreign multinationals consider them a minor constraint.

At the state level, similar observations can be made for NSW, although the availability of suitable labour features more prominently – nearly half of foreign multinationals see it as a minor constraint (Chart 13, black bars). Additionally, although demand is still the largest constraint for NSW foreign multinationals, a smaller proportion see it as a significant constraint compared to foreign multinationals in other states (Chart 13, red bars).

TECHNICAL DETAILS/DEFINITIONS:

Business confidence is a measure of respondents' expectations of business conditions in their industry for the upcoming quarter.

Business conditions are a simple average of **sales/revenue, profitability and employment indices**, reported by respondents for their company. The trading, profitability and other indices are calculated by taking the difference between the percentage of respondents nominating good or very good, or a rise and those nominating poor or very poor, or a fall, and the result is called the **net balance index**. For example, if 25 per cent of respondents report that trading levels are good or very good and 10 per cent state these levels to be poor or very poor, the corresponding net balance index of trading performance would be 15.

Foreign multinationals refers to firms with headquarters based overseas, but with Australian operations.

Australian headquarters refers to firms based within Australia, but with operations at multiple locations around the country.

Single location refers to firms that operate within Australia and do not have headquarters at separate location.

ABOUT THE MULTINATIONAL BUSINESS SURVEY

The Multinational Business Survey is part of the broader NAB Quarterly Business Survey, which is based on a telephone/weblink/e-mail survey of over 900 Australian firms. As at Q4 2016, nearly 200 firms indicated they were part of a foreign multinational for the purposes of this survey.

The survey is conducted by a third-party vendor, Gundabluey Research Pty Ltd. For the December issue, the survey was conducted between late November and early December, while the survey for the upcoming March issue will be conducted between late February and early March.

Given that the inaugural survey provides us with only one data point for each survey question, data in the early issues could be volatile from release to release as the implementation of a seasonal adjustment procedure to the series is not yet possible. We do expect, however, the interpretability and reliability of the data to improve as we get more data points for each survey question.

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