EMBARGOED UNTIL: 11.30AM THURSDAY 20 APRIL 2017

NAB QUARTERLY BUSINESS SURVEY

MARCH QUARTER 2017

National Australia Bank

Key points:

- The quarterly iteration of the NAB Business Survey provides additional insight into Australian business beyond that offered by the regular NAB Monthly Business Survey (with around double the sample size).. This publication grants a more in-depth probe into the conditions facing Australian business, and also provides extra information about how firms perceive the outlook for their respective industries.
- **Business conditions (an average of trading conditions/sales, profitability and employment) improved in the March quarter**, albeit not to the extent seen in the monthly Survey, driven by an increase in profitability and employment. Business conditions rose even further to +8 in Q1, well above the long run average of +1, but are yet to surpass the 2015/16 highs – in contrast to the March monthly Survey which showed conditions at their highest level since the GFC. **Business conditions were also positive for all industries other than retail**, with service industries still performing best. **Mining conditions are clearly seeing support from higher commodity prices**, pushing into positive territory for the first time since 2012. Meanwhile, **business confidence has barely moved in the past year,** holding at +6, marginally above the long-run average. Note that the Survey was conducted prior to Cyclone Debbie in March.
- **Leading indicators were more encouraging across the board** in the March quarter. Forward orders recovered the lost ground from the previous quarter, while expectations for business conditions in the next 3 and 12 months improved notably as well. **Capacity utilisation rates were higher** (at 81.9% compared with long-run average of 80.6%), which bodes well for labour demand and future capital expenditure. Consistent with that, both **employment expectations and capex plans (next 12 months) were higher** – firms also indicate that **it has become harder to find suitable labour**, suggesting a tighter labour market than the ABS unemployment rate currently suggests (p6).
- More **firms indicated that they were less comfortable with the current level of the AUD, compared to the previous quarter** – the Survey was conducted when the AUD averaged $US 0.76 (2 cents higher that the previous Survey). Wholesalers are showing the most discomfort with the AUD, followed by manufacturing. Construction firms have reported the greatest benefit as the AUD depreciated from the elevated levels of previous years, followed by manufacturing. In contrast, mining and transport have reported the largest negative impact.
- **The Survey is still pointing to very subdued inflationary pressures**. Nevertheless, input costs, while relatively restrained, still appear to be rising faster than final product prices (particularly labour costs), suggesting a degree of margin compression – the Survey's margins index remained negative in Q1. Product price inflation continued to be very subdued in Q1, at an annualised rate of 0.7% (0.2% in the quarter), while retail inflation was also soft despite accelerating slightly in the quarter – pointing to a relatively modest CPI outcome for Q1.

Table 1: Key quarterly business statistics*

	2016q3	2016q4	**2017q1**		2016q3	2016q4	**2017q1**
		Net balance				*Net balance*	
Business confidence	6	6	**6**	Trading	12	10	**10**
Business conditions				Profitability	7	6	**8**
Current	7	6	**8**	Employment	3	3	**5**
Next 3 months	17	14	**19**	Next 3 months	7	7	**11**
Next 12 months	25	24	**28**	Next 12 months		16	**19**
Capex plans (next 12)	24	22	**28**	Forward orders	4	1	**4**
% change				Stocks	2	3	**4**
Labour costs	0.4	0.5	**0.4**	Exports	1	2	**2**
Purchase costs	0.3	0.3	**0.2**				
Final products prices	0.1	0.2	**0.2**	Retail prices	0.1	0.0	**0.2**
				Capacity utilisation rate	81.1	81.0	**81.9**

* All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 20 Feb to 9 Mar 2017, covering around 915 firms across the non-farm business sector.

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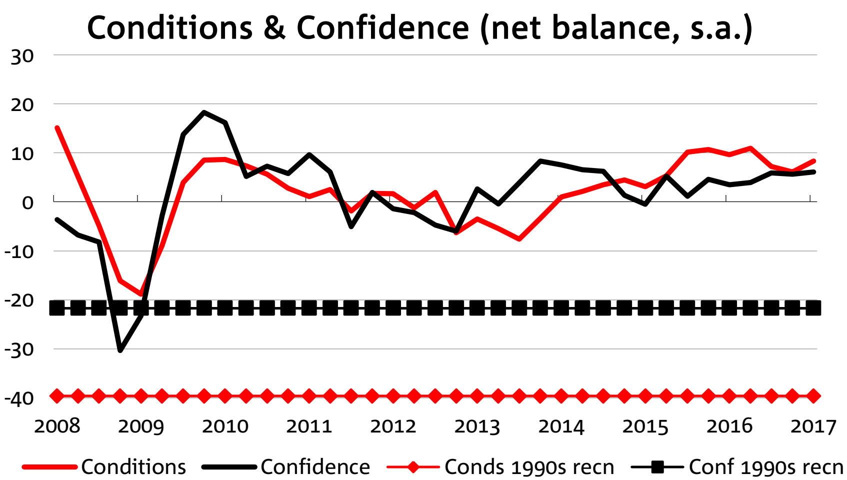

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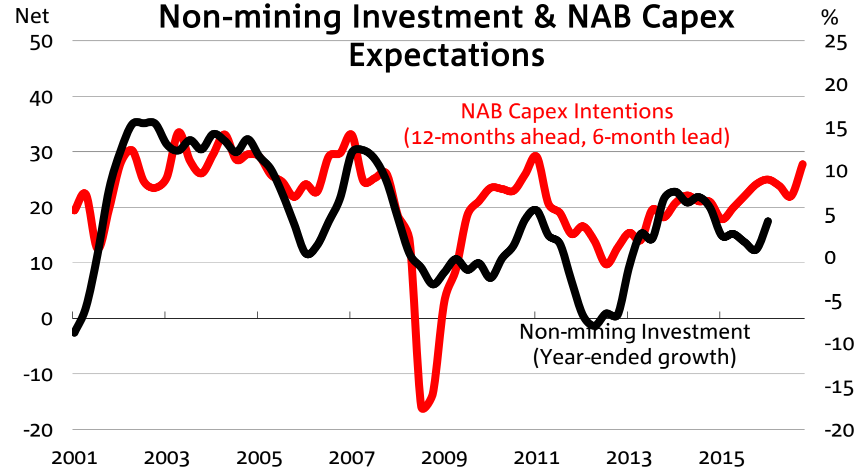
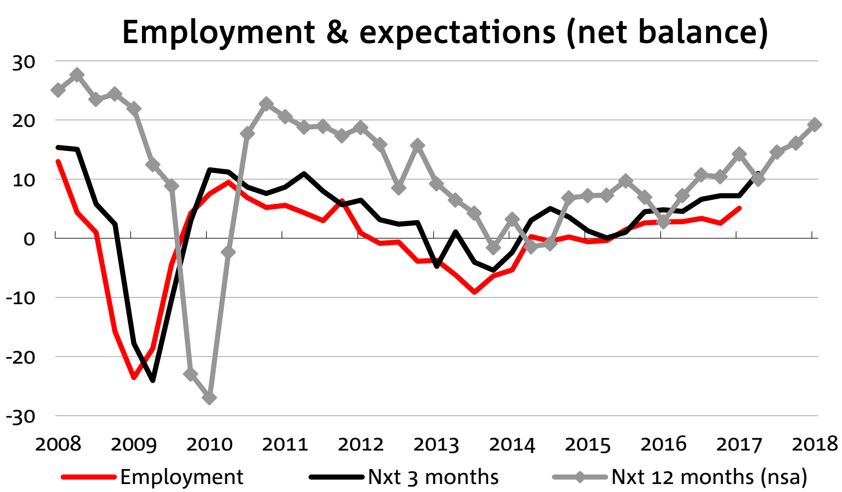
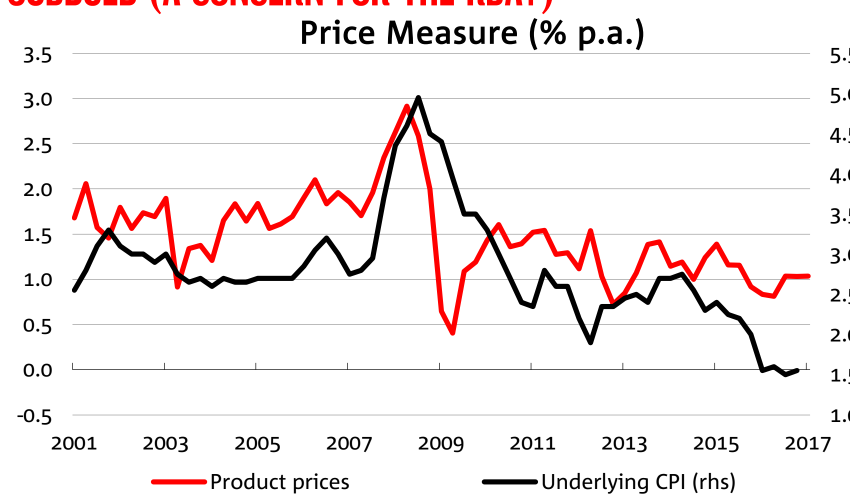


EMPLOYMENT INTENTIONS FOR NEAR AND LONGER-TERM SUGGEST MORE IMPROVEMENT IN THE LABOUR MARKET

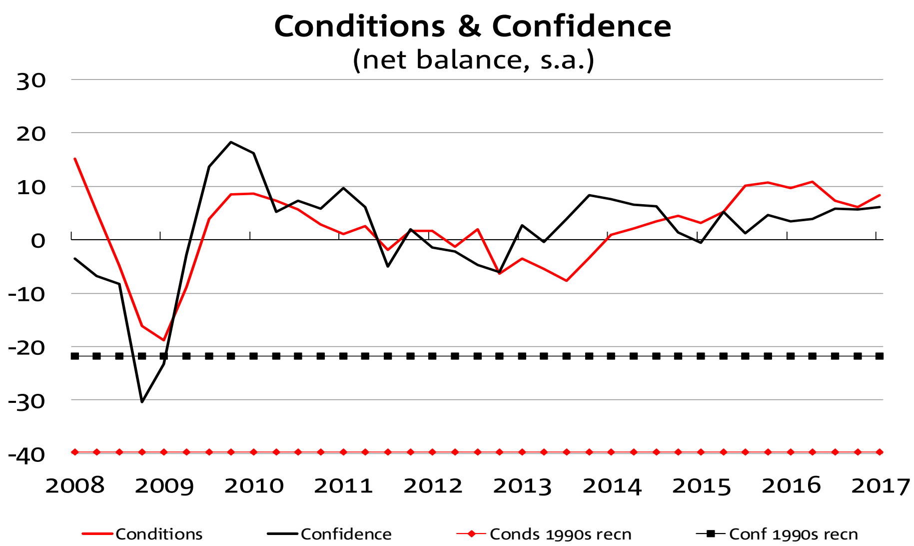


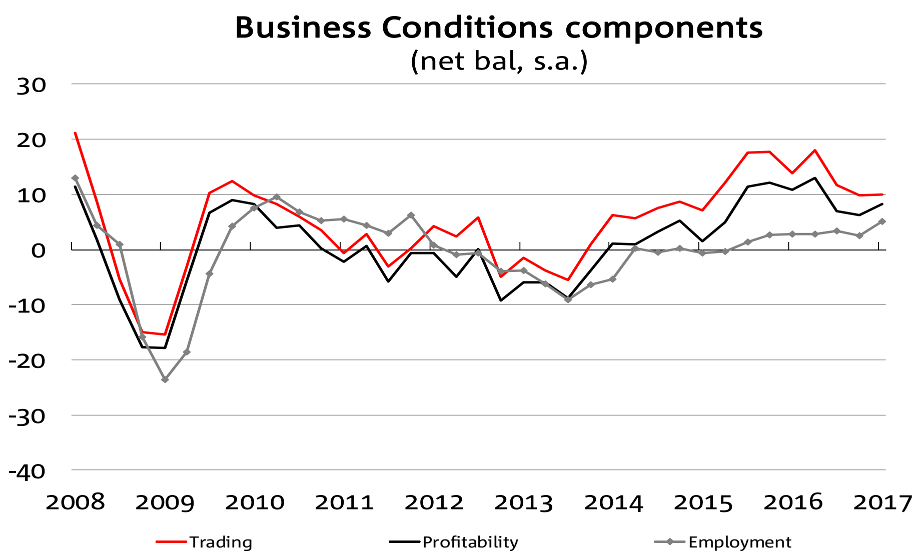
PRICE MEASURES IN THE NAB SURVEY REMAIN EXTREMELY SUBDUED (A CONCERN FOR THE RBA?)



BUSINESS CONDITIONS AND CONFIDENCE

Conditions partially rebound from recent declines, and are well above average



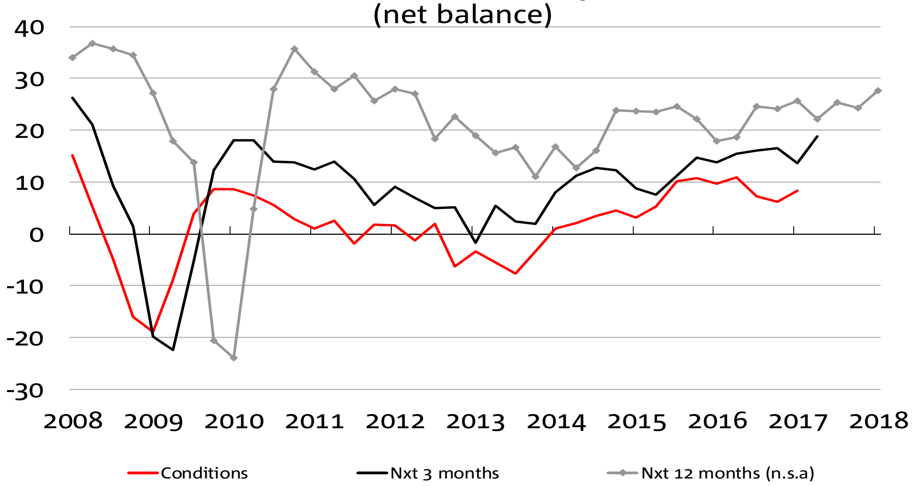


- There was an improvement in business conditions in the March quarter (up 2 points, to +8), which is a solid outcome that is well above the long-run average for the series (+1). Such a result indicates that the non-mining recovery has managed to gain more traction, at least in the near-term – despite previous AUD strength and an apparent tightening of credit conditions. Stronger then expected commodity prices are helping, as is the improving global economic environment. In terms of the components, the improvement was driven by profitability and employment, while trading conditions/sales was unchanged – albeit the highest of the three components. Employment conditions have consistently lagged behind the other components in recent years, but the gap has narrowed recently as employment conditions gradually improve while the other components dipped back below their recent peaks.
- By industry, the rise in business conditions was most apparent in wholesale (up 17) and mining (up 15) – consistent with the surprise strength and resilience of commodity prices. Note that the quarterly Survey was conducted prior to the disruptions to coal production from Cyclone Debbie. Retail (up 7) and finance/ property/ business (FPB) services (up 1) were the only other industries the strengthen. The remaining industries weakened modestly. In levels terms, wholesale become the best performer in the quarter (+17 points), although the industry has experienced some notable volatility of late in the monthly Survey. The major services industries (namely FPB services and personal & recreation services) are the next best performers. In contrast, retail is the worst performer – a concern given the importance of household consumption to growth (chart on p13).
- **Business confidence** was unchanged in the quarter and has been remarkably steady for an extended period. The confidence index remained at +6 index points – which is marginally above the long-run average. While this is a solid result, there is no clear evidence that improving sentiment towards the global economic outlook is having a material impact on business confidence, which may reflect lingering concerns around political tail risks. By industry, business confidence is positive across the board and only two industries recorded a decline in Q1 – manufacturing (down 5) and retail (down 1). Meanwhile, the improvement was in construction (up 8), followed by transport & utilities (up 4). Meanwhile, mining continues to see the (equal) highest level of confidence (+10), along with wholesale. Personal services is lowest (+2), despite solid conditions.
- **Forward orders** were more encouraging in the quarter (up 3), which is well above the long-run average for the series – pointing to reasonable momentum for business in the near term. Orders are highest in construction (+28), while orders are lowest in mining (-12) and transport (-5) – although personal services are negative as well.

OTHER LEADING INDICATORS AND INVESTMENT

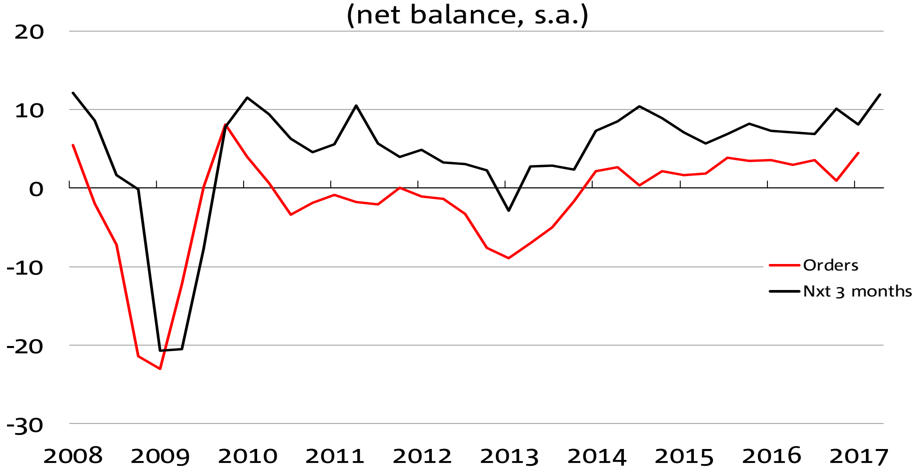
Leading indicators point to better momentum in Q1 2016 (before Cyclone Debbie)

Business conditions & expectations
(net balance)

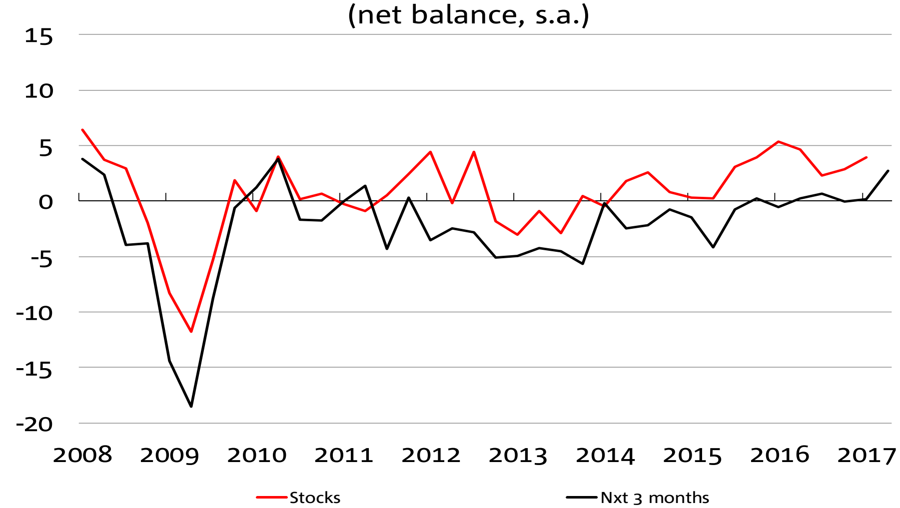


- In the quarterly survey, firms provide responses regarding their expectations for business activity going forward. Consistent with better current conditions, expectations for activity lifted in both the near term (3 months) and the longer term (12 months). Overall, leading indicators from the Survey clearly point to an improving economy, at least in the near-term (and prior to the disruptive effects of Cyclone Debbie). While the non-mining economy is generally improving, the drag from the mining sector also appears to be waning, assisted by higher commodity prices and the near completion of the investment cycle downturn.
- Expectations for forward orders (3 months ahead) were stronger as well in Q1, lifting to quite solid levels – near-term expectations are at their highest level since the GFC. Near-term expectations for profitability also jumped, while longer-term expectations (12-months ahead) improved modestly.
- Stocks can be another indicator of near-term activity. The stocks index rose again in the quarter, but is still slightly below recent highs. Nonetheless, the long-term trend shows a gradual improvement in response to strengthening trading conditions and positive orders. Firms had previously been reluctant to restock given uncertainty around the outlook, as well as cost and other competitive pressures. The gradual improvement in orders might suggest a slow shift in firms attitudes around the outlook.

Forward orders & expectations
(net balance, s.a.)

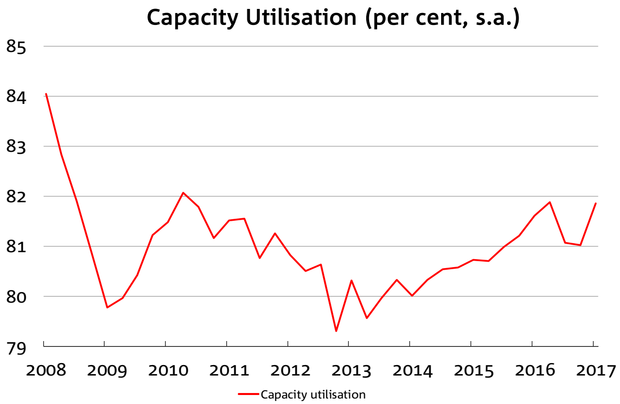


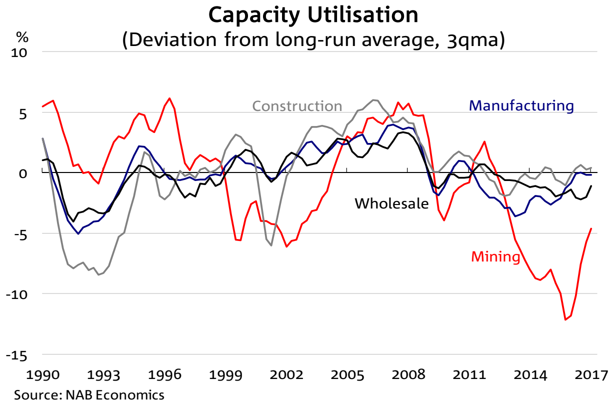
Stocks
(net balance, s.a.)

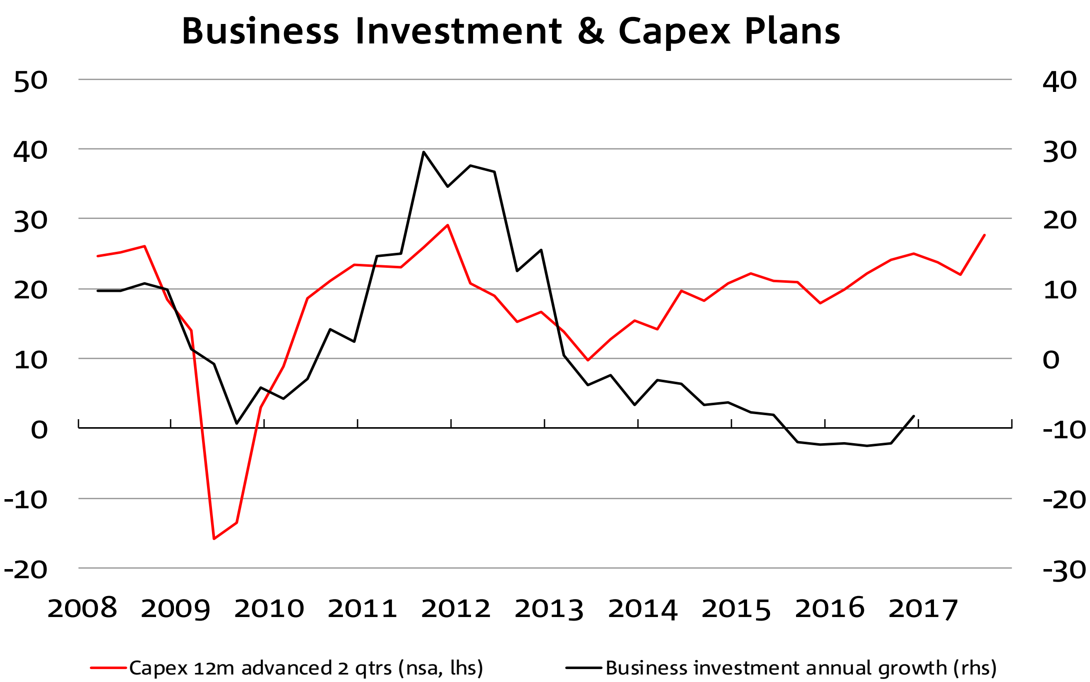


OTHER LEADING INDICATORS & INVESTMENT

Capacity utilisation rebounded, supporting solid capex







- **Capacity utilisation** rebounded in Q1, to 81.9%, recovering the ground that was lost over the past couple of quarters. Less spare capacity is consistent with the solid (or improving) result in the Survey with regard to labour demand and business investment.
- Mining and wholesale are showing capacity utilisation rates that are furthest below the long run average, although there has been a noticeable improvement in mining that is consistent with stronger commodity production in the final stages of the mining investment cycle. Meanwhile, retail and FPB services are highest above. With capacity utilisation now up from their 2012-13 lows, there is growing evidence of pass-through to investment decisions. Capex spending measures from the NAB Survey are looking good, especially when it comes to capex spending intentions which picked up even further in Q1 (see below).
- According to the **capital expenditure** measure included in the NAB Survey, business investment activity in Q1 partially recovered from the decline seen in the previous quarter – sitting above the long-run average. Mining (up 17) and wholesale (up 13) saw the biggest improvement in capex during the quarter, while transport deteriorated the most (down 6). Nevertheless, the capex index is positive for all industries but retail, and was especially strong in recreational & personal services (+19).
- When asked about their **future capex plans**, firms in the NAB Survey remain more upbeat than the ABS Capex Survey, although this partly reflects the differences in the industry mix across the two surveys, with the ABS version not including key services industries such as health, education and some community services. The NAB capex index for the next 12 months suggests investment growth should already be stronger and holding at relatively elevated levels. That said, the National Accounts have been suggesting stronger non-mining investment that is more consistent with the NAB Survey. Meanwhile, firms have been reporting little to no change in their **required rates of return** for new investment, suggesting that other factors are offsetting highly accommodative monetary policy.

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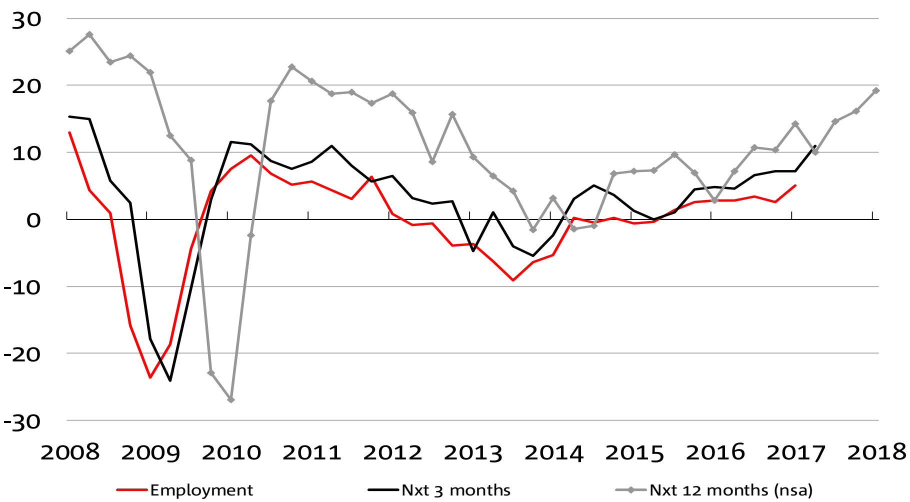
LABOUR MARKET

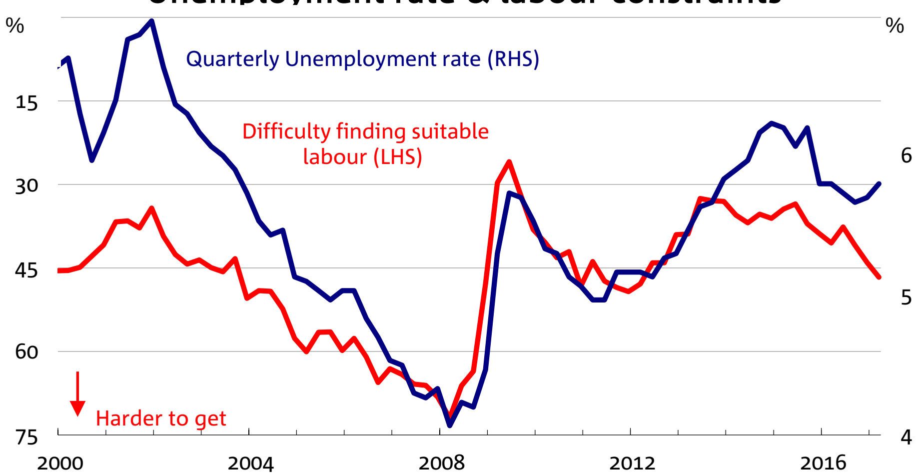
The outlook for the labour market is clearly improving

Employment & expectations (net balance)



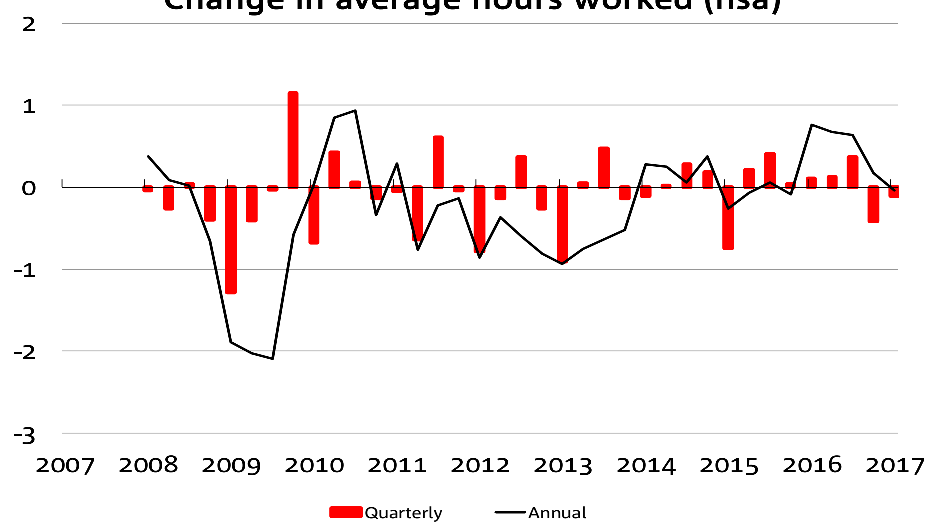
- The employment index from the Survey has been gradually improving in recent years, and is back to around its post-GFC peak. The index gained ground in Q1 (up 2 to +5 index points), suggesting better rates of employment growth that if sustained should lead to some improvement in the unemployment rate in the near-term. Average hours worked, however, fell slightly in the quarter.
- Near-term employment expectations were stronger at +11 index points (from +7), which is above its long-run average level. At the same time, longer-term expectations lifted, hitting a multi year high. Again, that outcomes suggest that the unemployment rate could see a gradually improvement in the longer-term, although NAB's forecast is for the unemployment rate to remain relatively steady given solid population growth and insufficient job creation (which includes the potential for further job losses coming out of the mining sector).
- On a positive note, firms are again suggesting that they have had greater difficulty in finding suitable labour – reflected in a clear trend within the NAB Survey measure since around mid-2015. Given the elevated rate of unemployment, that result suggests that even though the labour market remains fairly loose, there is a lack of workers with the right skills to match employers' needs.

Unemployment rate & labour constraints



Sources: ABS; NAB

Change in average hours worked (nsa)



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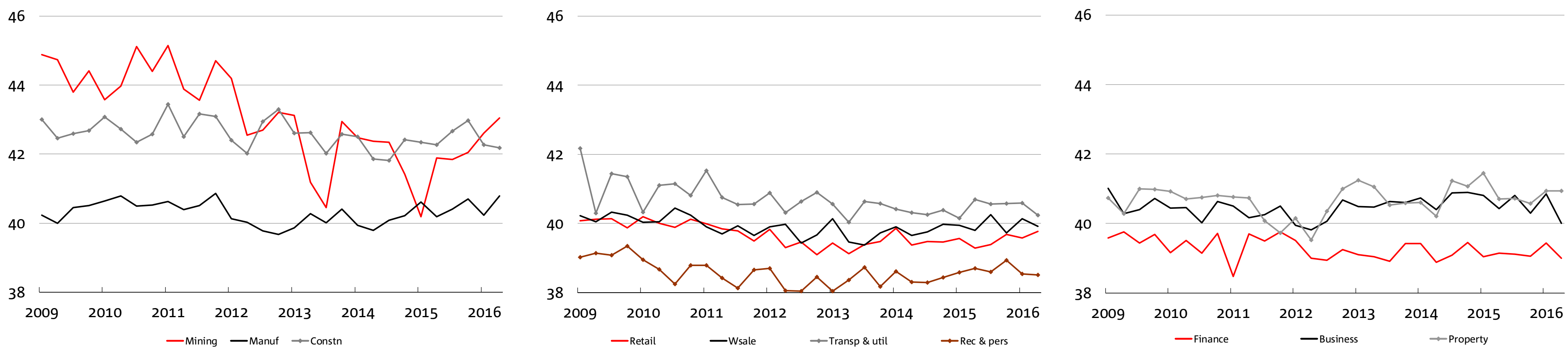
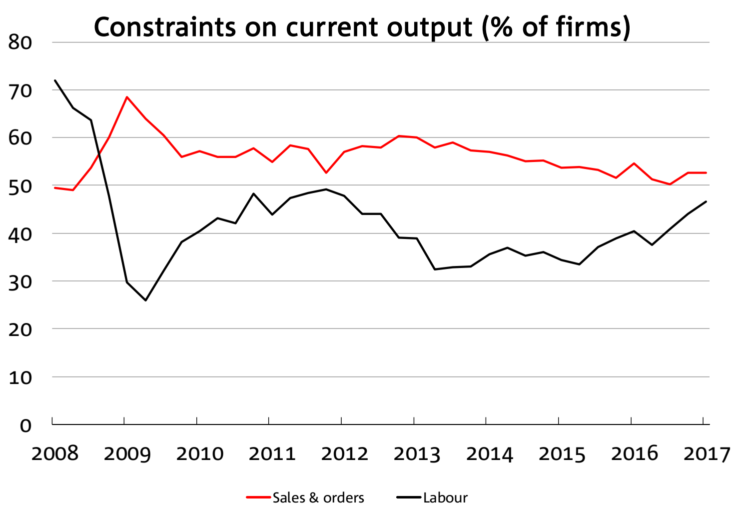
LABOUR MARKET (CONT.)

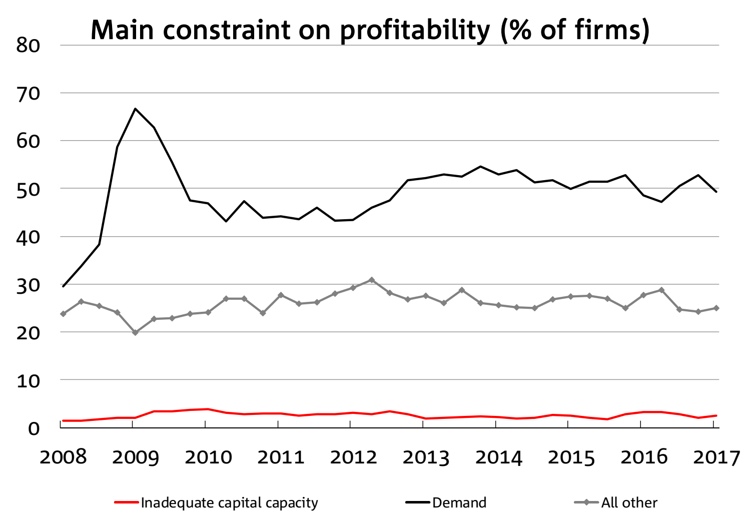
The lack of suitable labour is a growing constraint, despite loose labour market

Average weekly hours worked by industry (nsa)



Major constraints on firm output & profits

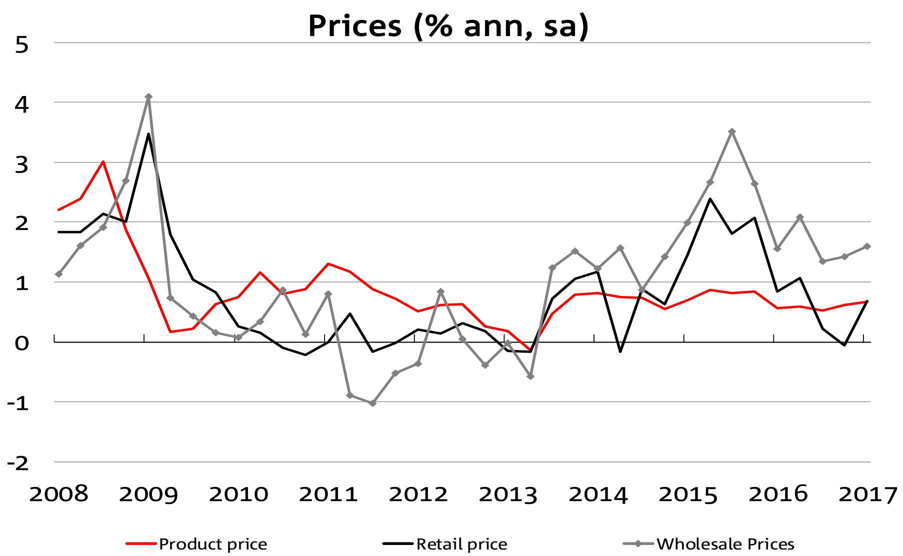


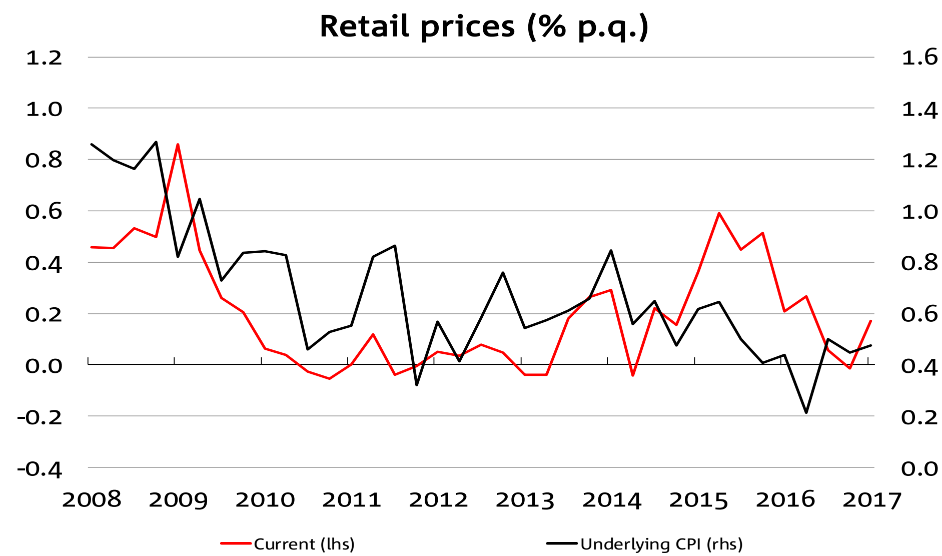


INFLATION PRESSURES

Inflation picture continues to look fairly subdued

- The inflation picture remains important for expectations around RBA policy settings, especially with underlying inflation widely anticipated to remain below the RBA's 2-3% target band. The Q4 CPI outcome came in on the soft side, but largely aligned with RBA expectations, contributing to the decision to keep the cash rate unchanged at recent Board meetings – although other considerations also played a part in the decision. The broad picture on inflation provided by the Business Survey has not changed a great deal since last quarter. It continues to suggest very muted price pressures across the economy, although some of the measures did pick up modestly. Inflation pressures emanating from the wholesale and retail sectors remain well down on their 2015 peaks, although the former is still well above the average for the other industries. Meanwhile, the retail price index has been much more muted than wholesale, suggesting that either competitive pressures or subdued demand (or both) are stifling their ability to pass on higher costs to consumers at this stage – retail labour costs are also running ahead of prices (see below). There has also been evidence in recent retail sales data from the ABS of heavy discounting, possibly reflecting the closure of certain retail chains.
- Growth in final product prices rose slightly to 0.7% annualised (was 0.6%) and a 0.2% quarterly rate. Both purchase cost and labour cost inflation are running faster, despite being a little lower in Q1 (at a quarterly rate of 0.2% and 0.4% respectively). Retail price inflation accelerated the most in the quarter (up 0.2 ppts), while mining and transport prices slowed the most (both down 0.2 ppts). In levels terms, wholesale price inflation was strongest in the quarter (0.4%), followed by personal services prices (0.3%). In contrast, transport price inflation was weakest at -0.1%. Looking forward, inflation expectations for the next 3 months are broadly steady, pointing to very subdued price pressures persisting, with final price inflation expected to be at around an annualised rate of 1% (0% for retail inflation).
- Even though input costs are still growing faster than final prices, firms are now reporting much better profit margins than they have for a number of years – although the index is still in negative territory. Mining, wholesale and FPB services were the only industries to report a non-negative margins index in Q1 2017. Retail is still seeing the worst profit margins despite a lift in prices during the quarter.

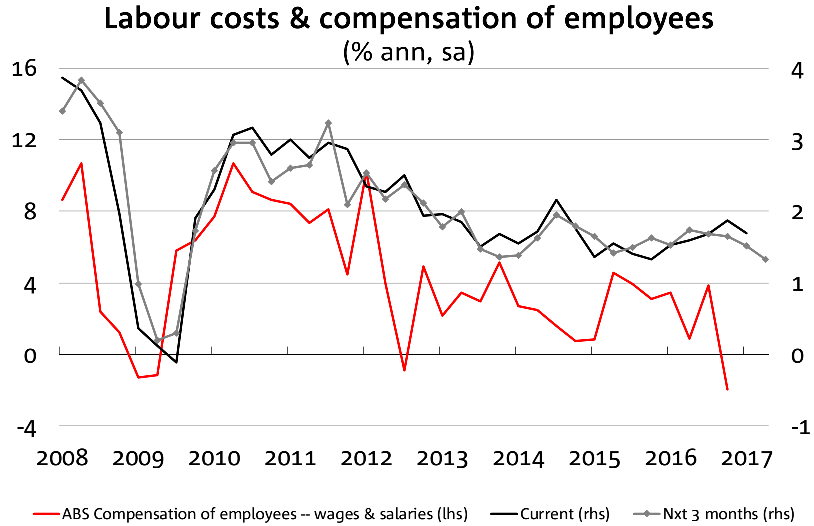


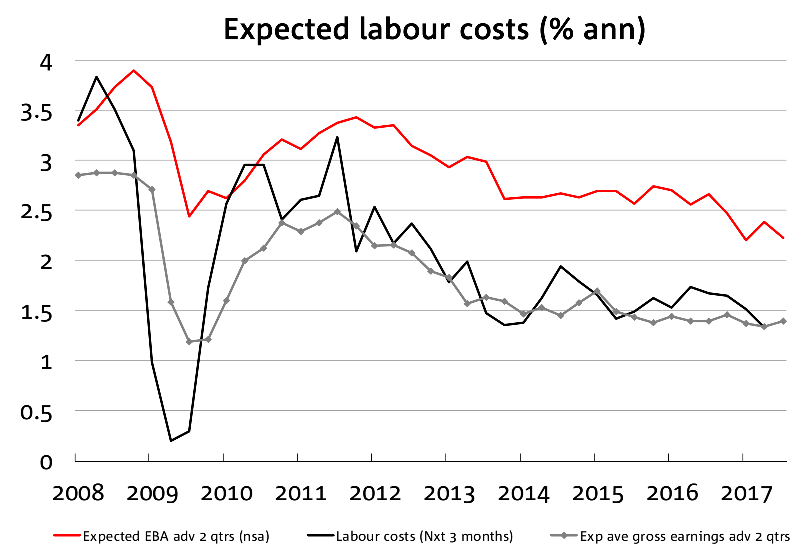


LABOUR COSTS (DETAILS) AND EXPECTATIONS FOR AUD, RATES AND INFLATION

Wage pressures still look very muted with no sign of a lift in the near-term

- Annualised growth in labour costs eased slightly to 1.7% in the quarter (from 1.9%), which is below the series average of around 2.8% since 1989. Wage cost pressures have remained relatively subdued despite a steady improvement in the level of employment conditions and reports of greater difficulty finding suitable labour – although consistent with the elevated official unemployment rate. The Survey's measures of expectations for labour costs (next 3 months) suggests a continuation of the subdued wage trend into the near term. Wage increases under EBAs are expected to average just 2.2% over the next year, or 1.4% after allowing for productivity offsets.
- On average, businesses are now pricing in around a 60% probability of a 25bp hike in the next 12-months. In contrast, NAB Economics view is that the RBA will keep rates on hold for the foreseeable future, although the possibility that more cuts are needed is higher than the risk of rate hikes in the next 18 months. NAB Economics remain cautious about the medium-term outlook given the likely impact from flattening resource exports and slowing residential construction on growth and the labour market. Exchange rate expectations in the Survey (6-months-ahead) rose to US$0.75, which is a little lower than at the time the Survey was taken.
- The inflation outlook remained soft, but there were some signs of expectations lifting a little, with 70% of respondents expecting inflation to remain below 3% (a little less than 6-months ago), while almost a quarter (24%) are expecting inflation of 3-4% (up from last quarter). However, only 3% of firms believe inflation is a serious problem (similar to last quarter), while 31% believe it is a minor problem (unchanged from Q4).



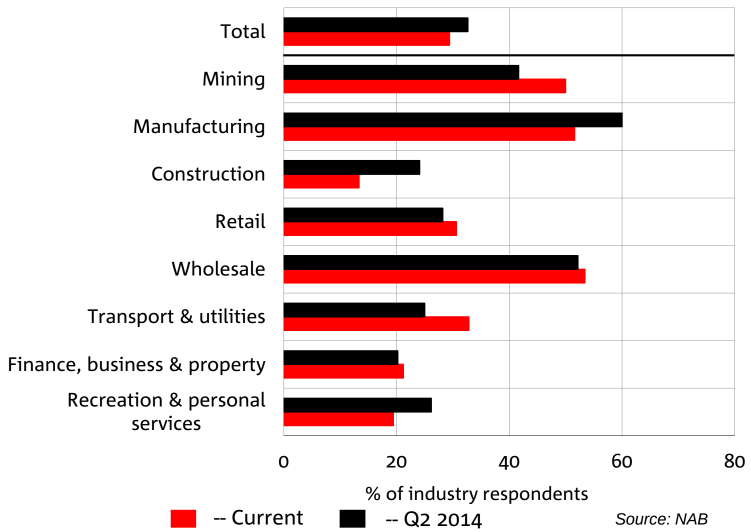


	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	1.0	2.3	2.6	2.0	2.3	1.9	2.3	1.9	2.2
Productivity offset	0.6	1.2	0.6	1.5	0.8	0.7	0.7	0.5	0.8
Net EBA growth	0.4	1.1	2.0	0.5	1.6	1.3	1.6	1.5	1.4

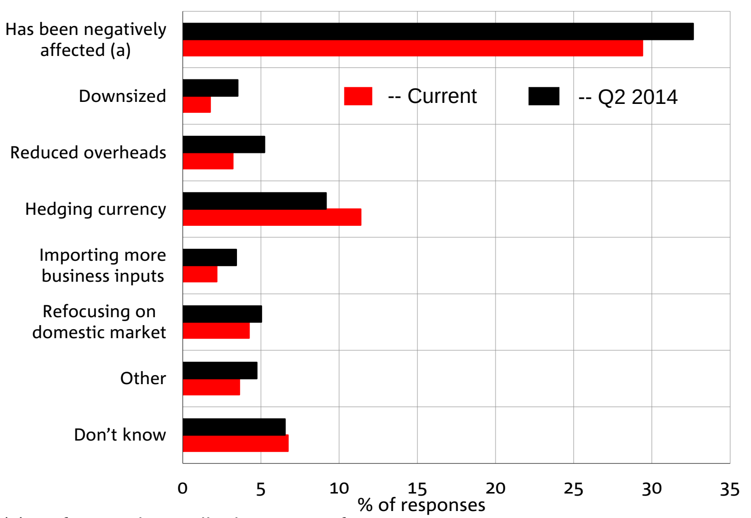
BUSINESS & AUD

AUD benefits best seen in manufacturing, construction & personal services

Has been negatively affected by level of Australian dollar



Responses to negative effects of level of Australian dollar



(a) % of respondents. All others are % of responses

Source: NAB

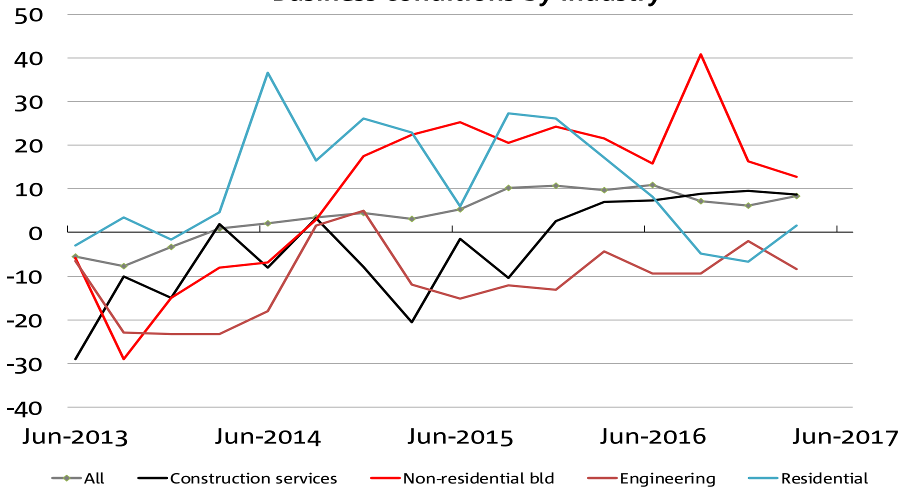
- In NAB's Quarterly Business Survey, we have asked businesses how they have been affected by the level of the Australian dollar, and what strategies they have been using to mitigate the negative impacts. The interviews for this question were conducted between 20 February and 9 March, when the exchange rate averaged $US 0.76 and 64.9 on a TWI basis. The AUD/USD was around 2 cents higher, while the TWI was slightly stronger than the average seen during the Q4 survey period. The AUD has fluctuated since then, but has recently returned to around $US 0.75.
- According to the survey, almost a third of non-farm businesses reported an adverse impact from the AUD at current levels. That is slightly higher than Q4 2016, but is still down on levels seen in mid-2014 – prior to the big depreciation of the AUD. The magnitude of the improvement since mid-2014 seems relatively small, which is likely to be underestimating the true benefits of the depreciation for the economy. A reason for this is the notable disparity in currency effects across industries, although interestingly a majority of our industry grouping report more negative AUD impacts now than when the currency was much stronger – these are offset by strong improvements in a subset of industries including personal services, which has a particularly large weighting in the Survey.
- Trade exposed industries such as manufacturing have improved, along with the construction industry which has reported notable benefits from AUD depreciation since mid-2014 – possibly reflecting the benefits of a lower AUD to foreign investors in the industry. Surprisingly, the mining industry is no longer pointing to benefits from AUD depreciation, despite the fact that commodities tend to be priced in USD while much of the cost is incurred in AUD. Other industries to see strain from AUD depreciation include retail and wholesale, which can tend to be highly reliant on imports – even more so following an extended period of AUD strength – similarly the case for transport.
- In terms of how businesses are responding to the negative effects, hedging remains the most common strategy and has gained in popularity as the AUD has depreciated. In contrast, other strategies to counter currency risk have generally waned in popularity, including downsizing and cost cutting. By industry, recreation & personal services seem to have the highest share of firms that are uncertain about what strategies to employ to manage currency risk.

SOME INDUSTRY DETAILS: CONSTRUCTION

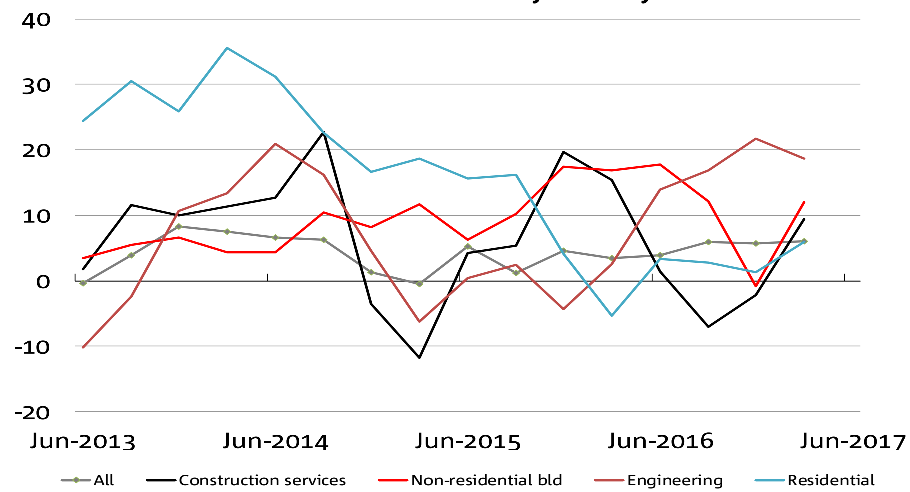
Non-residential construction weakened again. Residential up, but still soft.

- Business conditions for the construction industry took another step back in the March quarter, driven by a deterioration in non-residential building and engineering. Meanwhile, conditions in residential construction lifted back into positive territory, but continue to look relatively soft, especially in light of the residential property market boom – possibly a reflection of apartment oversupply concerns or tightening credit conditions. As expected, engineering construction conditions remain weak, in line with falling mining investment, although the commodity price rally may have also contributed to improvements in confidence for the sub-sector. Confidence also improved in the other subsectors, despite uncertainty around potential policy responses to contain property market and financial stability risks.

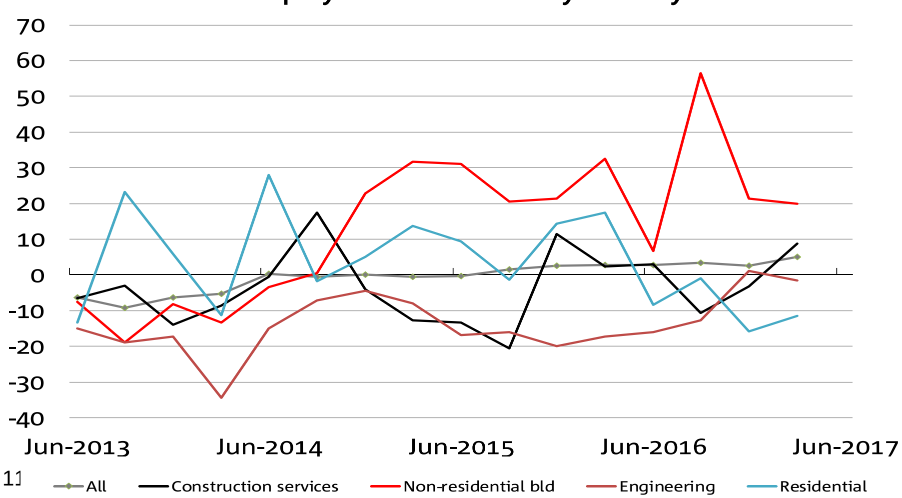
Business conditions by industry



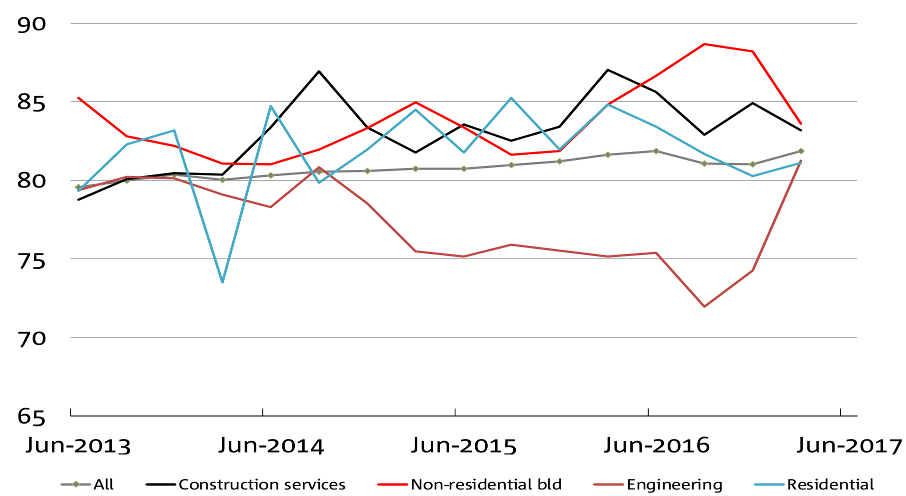
Business confidence by industry



Employment conditions by industry



Capacity utilisation by industry



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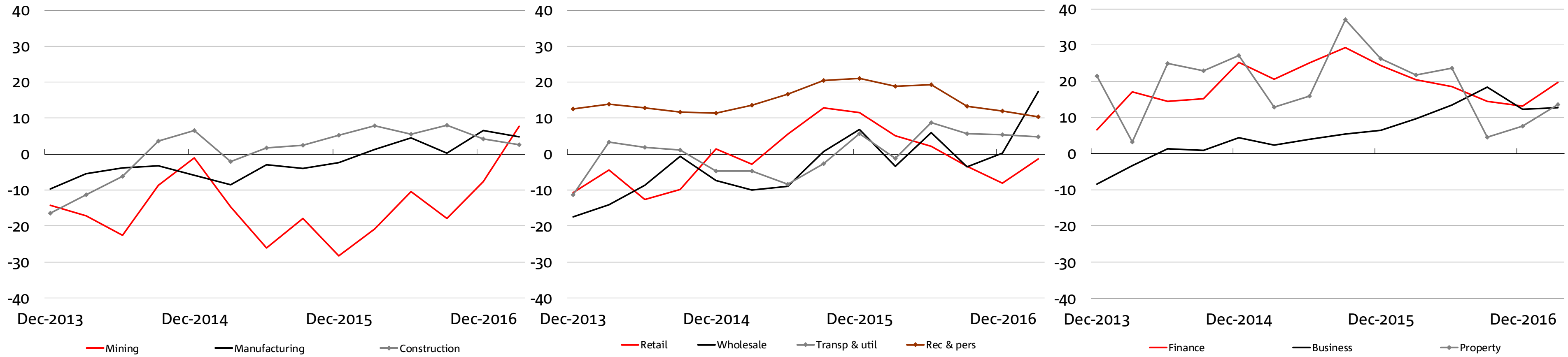
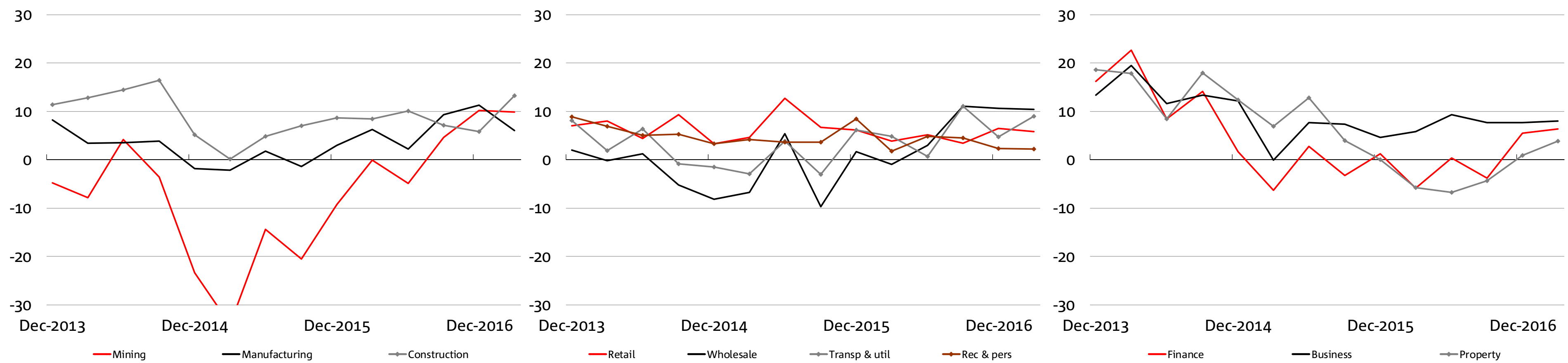
MORE DETAILS ON INDUSTRY

Mining seeing the benefits of higher commodity prices. Retail still a concern

BUSINESS CONDITIONS BY INDUSTRY (NET BALANCE): 3-MONTH MOVING AVERAGE



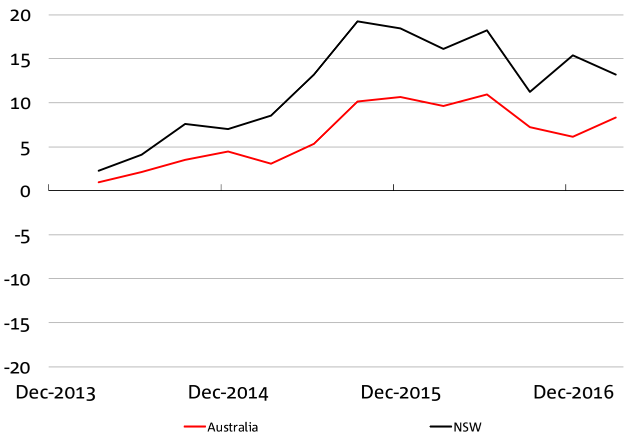
BUSINESS CONFIDENCE BY INDUSTRY (NET BALANCE): 3-MONTH MOVING AVERAGE

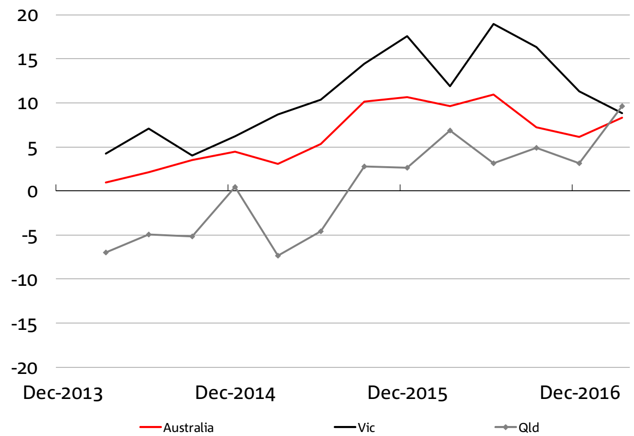


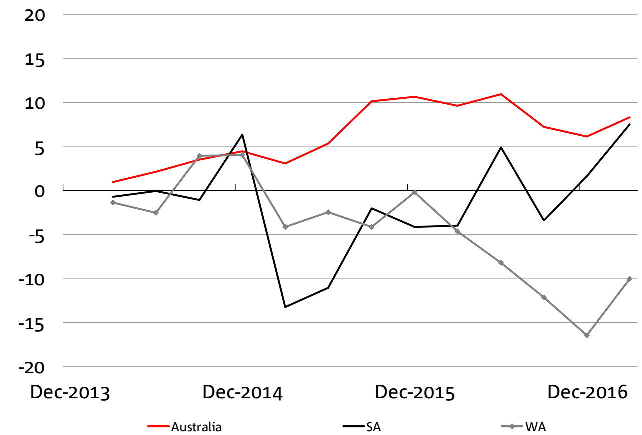
MORE DETAILS ON STATE

NSW the best performer, but mining states clearly improving

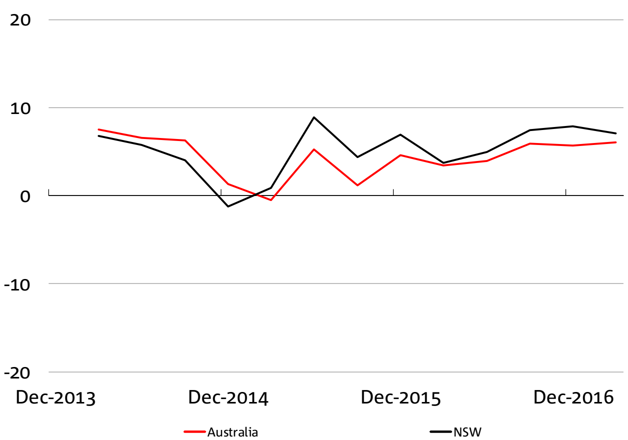
BUSINESS CONDITIONS BY STATE (NET BALANCE): 3-MONTH MOVING AVERAGE

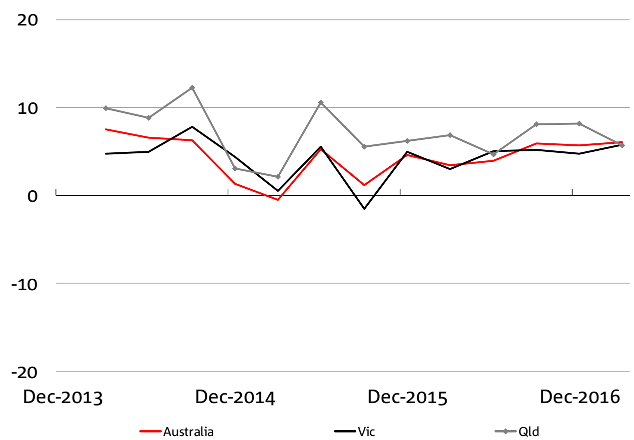


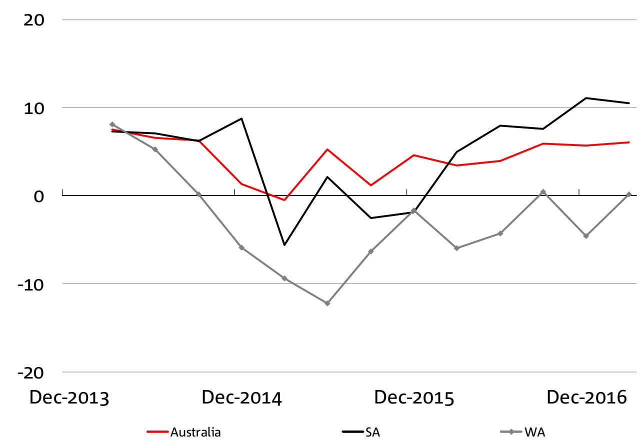




BUSINESS CONFIDENCE BY STATE (NET BALANCE): 3-MONTH MOVING AVERAGE







DATA APPENDIX

	Quarterly 2016q1	2016q2	2016q3	2016q4	**2017q1**	*Monthly* 2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Confidence	3	4	6	6	**6**	6	6	9	7	6
Conditions	10	11	7	6	**8**	7	11	13	9	14

	Quarterly 2016q1	2016q2	2016q3	2016q4	**2017q1**	*Monthly* 2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Trading	14	18	12	10	**10**	12	18	19	12	22
Profitability	11	13	7	6	**8**	7	13	14	10	13
Employment	3	3	3	3	**5**	2	2	6	5	5

	Quarterly[(a)] 2016q4	2017q1	2017q2	2017q4	2018q1	*Monthly* 2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Conditions	6	**8**				7	11	13	9	14
Conds. next 3m	17	14	**19**							
Conds. nxt 12m	24	26	22	24	**28**					
Orders	1	**4**				1	5	2	2	4
Orders next 3m	10	8	**12**							

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

	Quarterly[(a)] 2016q2	2016q3	2016q4	2017q1	**2017q2**	*Monthly* 2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Capacity utilis.	81.9	81.1	81.0	**81.9**		81.4	80.9	81.5	81.4	81.9
Stocks current	5	2	3	**4**		3	0	3	3	3
Stocks next 3m	0	1	0	0	**3**					

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

Constraints on output (% of firms)*	2016q1	2016q4	2017q1
Sales & orders	50.3	52.6	**52.6**
Labour	40.9	44.0	**46.7**
Premises & plant	20.3	22.0	**24.0**
Materials	7.7	9.3	**8.9**

Main constraints on profitability (% of firms)*	2016q1	2016q4	2017q1
Interest rates	2.3	2.1	**1.5**
Wage costs	12.7	10.1	**11.0**
Labour	7.0	8.8	**10.6**
Capital	2.8	2.1	**2.5**
Demand	50.5	52.8	**49.3**
All other	24.7	24.2	**25.0**

** not s.a.*

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DATA APPENDIX

	Quarterly [(a)]					*Monthly*				
	2016q4	2017q1	2017q2	2017q4	2018q1	2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Empl current	3	**5**				2	2	6	5	5
Empl next 3m	7	7	**11**							
Empl nxt 12m	10	14	10	16	**19**					

(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	1.0	2.3	2.6	2.0	2.3	1.9	2.3	1.9	2.2
Productivity offset	0.6	1.2	0.6	1.5	0.8	0.7	0.7	0.5	0.8
Net EBA growth	0.4	1.1	2.0	0.5	1.6	1.3	1.6	1.5	1.4

State Tables

	Quarterly					*Monthly*				
	2016q1	2016q2	2016q3	2016q4	**2017q1**	2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Business conditions										
NSW	16	18	11	15	**13**	17	17	20	14	15
VIC	12	19	16	11	**9**	10	15	15	11	12
QLD	7	3	5	3	**10**	3	5	4	8	20
SA	-4	5	-3	2	**8**	1	6	6	22	9
WA	-5	-8	-12	-16	**-10**	-14	-1	-3	-12	3

	Quarterly					*Monthly*				
	2016q1	2016q2	2016q3	2016q4	**2017q1**	2016m11	2016m12	**2017m1**	**2017m2**	**2017m03**
Business confidence										
NSW	4	5	7	8	**7**	8	0	8	6	4
VIC	3	5	5	5	**6**	4	9	12	5	5
QLD	7	5	8	8	**6**	12	15	12	8	12
SA	5	8	8	11	**10**	8	2	3	13	8
WA	-6	-4	0	-5	**0**	-7	3	6	3	7

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