

NAB QUARTERLY BUSINESS SURVEY

DECEMBER QUARTER 2017



Key points:

- The quarterly NAB Business Survey gives a more in-depth probe into the conditions facing Australian business than the monthly survey, 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) rose a little further in Q4**, from already elevated levels. **Business conditions rose to +15 in Q4**, which is well above the long run average of +1 and is its highest level since early 2008. Business conditions were also positive in all industries for only the second time since early 2008. However, retail conditions continues to lag well behind the other industries, despite a notable improvement in the quarter.
- The quarterly Survey continued to show a disconnect between **business confidence (which dipped 2 points, to +6 index points)** and business conditions, although the monthly Survey indicated a reconvergence late in the quarter following a spike in confidence. Yet, despite reporting a slight deterioration in confidence during Q4, firms still indicated even stronger investment intentions over the next 12 months – consistent with the steady rise seen in capacity utilisation rates. **Firms that experienced a deterioration in confidence are largely pointing to wage costs, along with the business outlook and broader margin pressure as the primary factors behind the change** (detail on p4).
- Overall, most leading indicators improved in Q4 and are maintaining levels that suggest continued expansion in the next 12 months.** Forward orders were up, as were expectations for business conditions in both 3 months and 12 months time. The **capacity utilisation rate was up slightly** (at 82.5% compared with long-run average of 80.6%), which is an encouraging sign for both future labour demand and capital expenditure. Consistent with that, both **employment expectations and capex plans (next 12 months) strengthened**. That said, **growth in labour costs (a wage bill measure) steadied, but other indicators from the Survey are pointing to a tighter labour market**. In particular, **more firms indicated that it is more difficult to find suitable labour than it was a year ago** – an indicator which tends to be highly correlated with the unemployment rate (p7 & 8).
- Looking at the construction industry in more detail, residential construction conditions eased slightly, but remain quite positive despite concerns about oversupply, while other construction and construction services have been steadily improving (see p12 for details).
- The Survey is suggesting subdued inflationary pressures, but labour costs (a wage bill measure) are still well up from their recent lows.** Product price inflation rose modestly, while price growth for final products was steady – yet the Survey's margin index actually improved. Retail prices saw only modest growth in the quarter too, according to the Survey.

Table 1: Key quarterly business statistics*

	2017q2	2017q3	2017q4		2017q2	2017q3	2017q4
	Net balance				Net balance		
Business confidence	8	8	6	Trading	18	19	18
Business conditions				Profitability	12	15	15
Current	14	14	15	Employment	11	9	10
Next 3 months	22	21	24	Next 3 months	12	12	15
Next 12 months	27	28	31	Next 12 months		22	24
Capex plans (next 12)	26	27	29	Forward orders	6	6	9
	% change			Stocks	5	3	3
Labour costs	0.6	0.7	0.6	Exports	1	2	2
Purchase costs	0.4	0.3	0.4	Retail prices (% change)	-0.1	0.1	0.1
Final products prices	0.2	0.2	0.2	Capacity utilisation rate	82.1	82.1	82.5

* All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 20 Nov to 8 Dec 2017, covering more than 900 firms across the non-farm business sector.

CONTENTS

Key points	1
Summary charts	2
Business Conditions & Confidence	3
Other leading indicators & investment	5
Labour market	7
Inflation	9
Labour costs & the AUD	10
Details: Construction	11
Data appendix	12

CONTACTS

Alan Oster, NAB Chief Economist,
+61 3 8634 2927

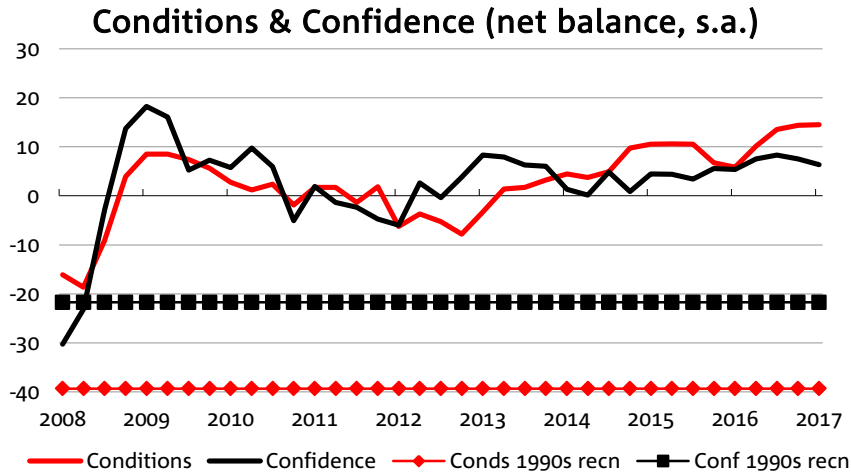
Riki Polygenis, Head of Australian Economics, +61 475 986 285

James Glenn, Senior Economist - Australia, +61 2 9237 8017

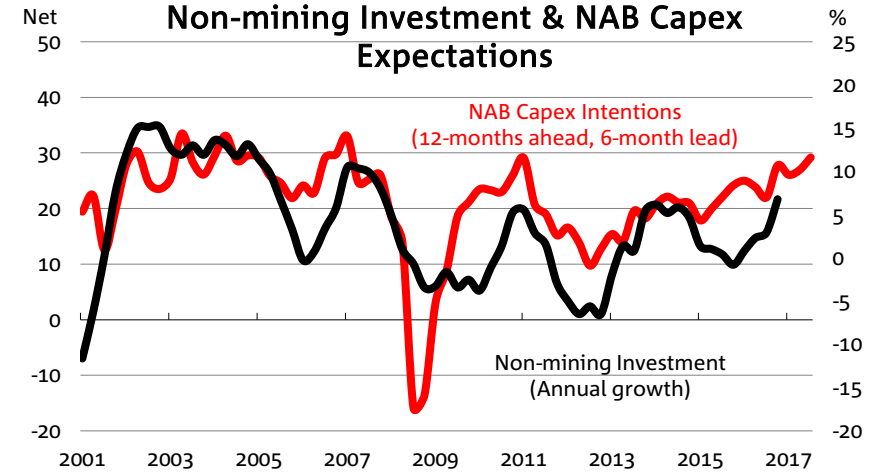
SUMMARY CHARTS

Leading indicators strengthen further, but inflation has remained muted.

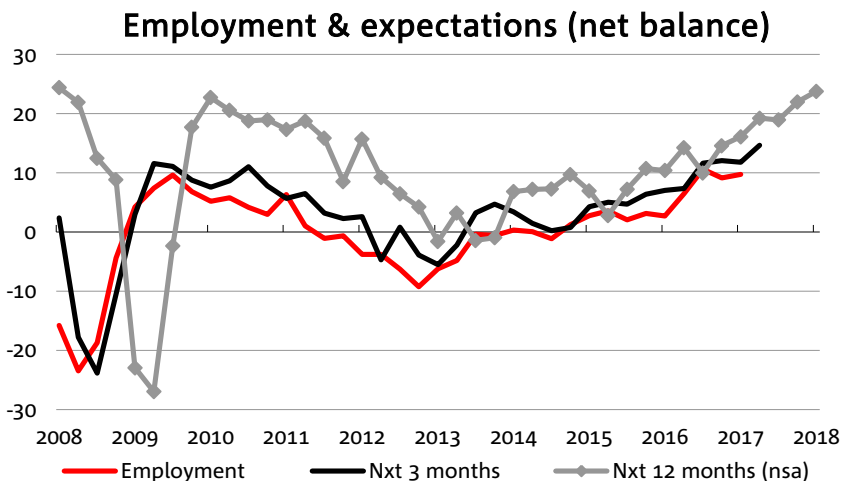
BUSINESS CONDITIONS HOLDING UP. BUSINESS CONFIDENCE SOFTER, BUT IMPROVED LATE IN THE QUARTER.



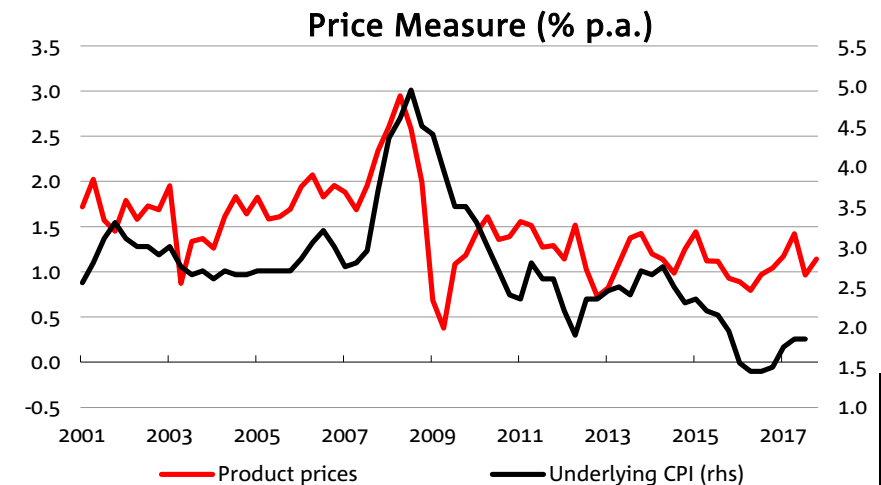
INVESTMENT INTENTIONS VERY STRONG, SUGGESTING MORE OF A LIFT IN NON-MINING INVESTMENT



EMPLOYMENT INTENTIONS STEADILY ON THE RISE, AND SHOULD SEE FURTHER FALLS IN THE UNEMPLOYMENT RATE



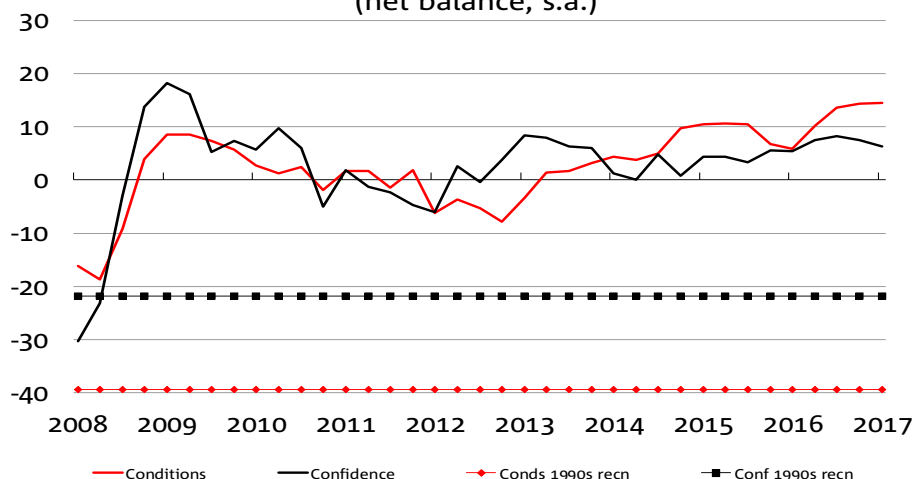
PRICE MEASURES IN THE NAB SURVEY ARE YET TO SHOW A SUSTAINED PICK-UP



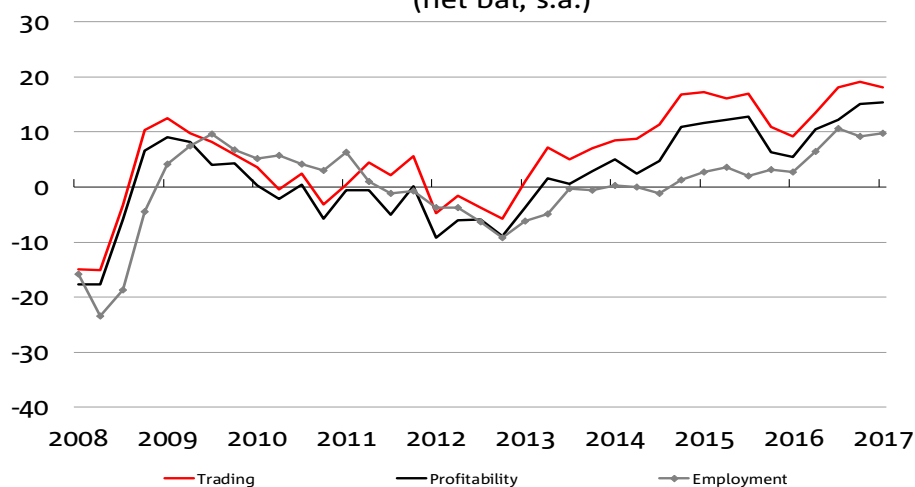
BUSINESS CONDITIONS AND CONFIDENCE

Business conditions steam further ahead, and forward orders are up

Conditions & Confidence
(net balance, s.a.)



Business Conditions components
(net bal, s.a.)

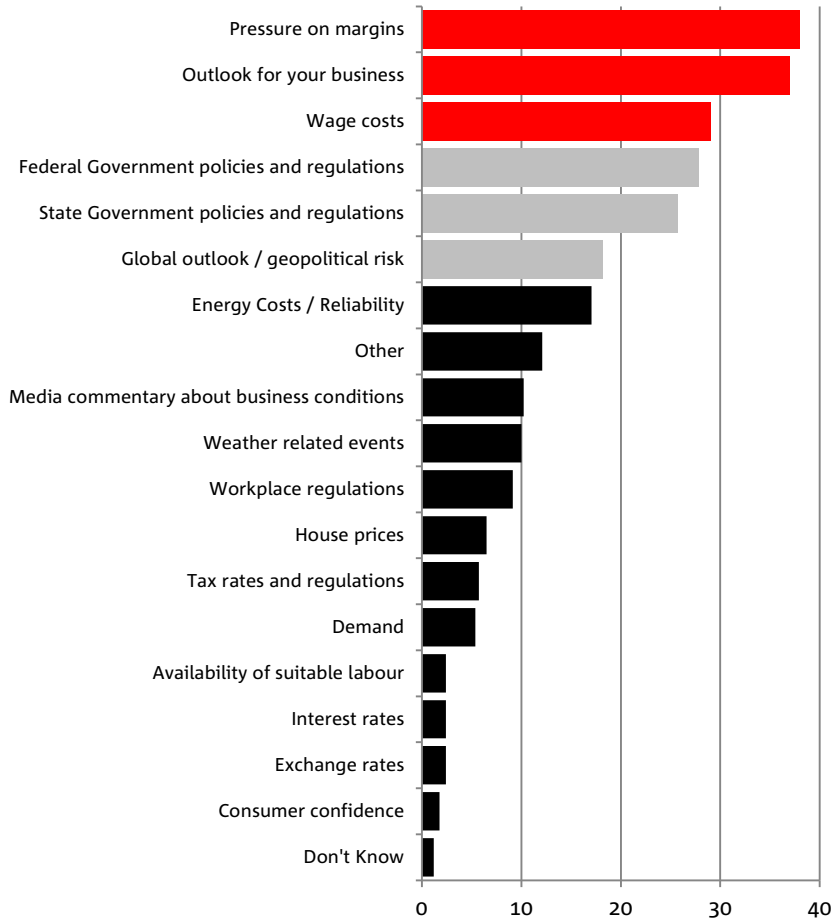


- **Business conditions** rose again in the December quarter (up 1 points, to +15), which is a multi-year high and well above the long-run average for the series (+1). The change in conditions varied across industries, but all are now recording positive levels – only the second time since early 2008. In terms of the components, the improvement during the quarter was driven by employment conditions, while profitability was steady and trading conditions were modestly lower.
- **By industry**, conditions are positive across the board, but retail continues to lag behind, despite a notable improvement in Q3. Poor retail conditions reflect the numerous challenges facing the sector at present, including tougher competition, subdued demand and other structural changes. However, this also poses a significant challenge to the outlook for the broader economy. In contrast, construction conditions remain solid, supported by a large pipeline of retail and infrastructure projects, as well as improvements in business investment. Mining has also remained a high performer, despite easing a little in the quarter, with support coming from higher commodity prices and less of a drag from mining investment (chart p12).
- **Business confidence** disconnected further from business conditions in the Q4 Survey, although NAB's Monthly Business Survey showed that confidence closed much of the gap late in the quarter. The quarterly confidence index eased 2 points, to +6 index points in Q4, which is a little above the long-run average. Business confidence is positive across all industries, although retail, wholesale and personal services drove softer confidence in the quarter (chart p12). Meanwhile, confidence lifted the most in construction, suggesting the industry is shrugging off concerns around apartment supply and challenging conditions for investors. Mining is reporting the highest level of confidence (+25), followed by construction (+18), while wholesale is lowest (at +2).
- When asking firms about **what is having the biggest impact on confidence**, the majority are pointing to considerations around margins, the demand outlook, and wages costs. Wage costs are particularly prevalent for firms reporting a deterioration in confidence (see p4).
- **Forward orders** were up in the quarter (up 1), pushing the index even further above the long-run average for the series – pointing to reasonable momentum for business in the near term. Orders are highest in mining (+30) and construction (+28), while they are lowest in personal services (+2).

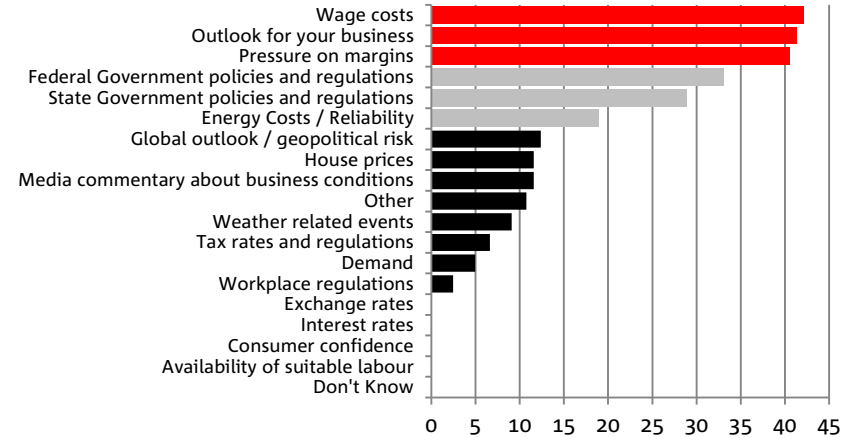
DRIVERS OF BUSINESS CONFIDENCE

Wage costs, margins and demand outlook are driving weaker confidence.

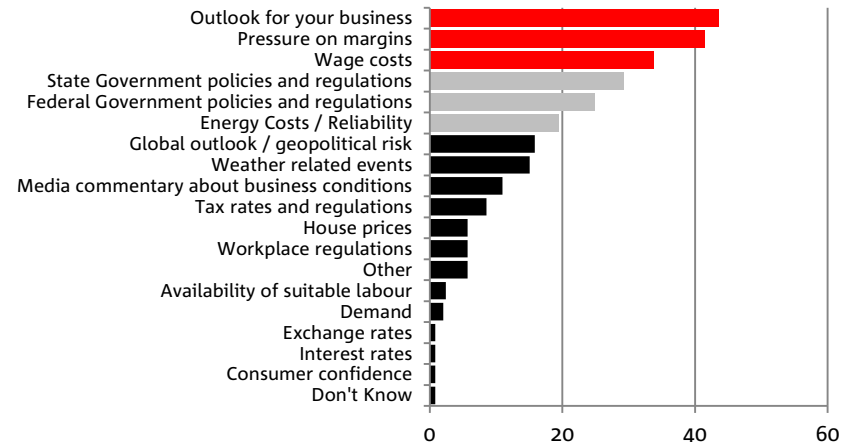
Most influential issues affecting business confidence



Most influential issues affecting business confidence - Deteriorating Confidence



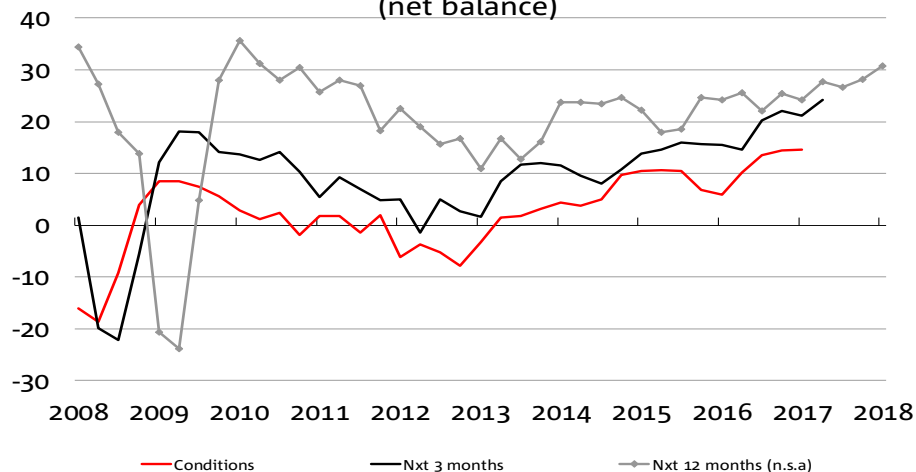
Most influential issues affecting business confidence - Improving Confidence



OTHER LEADING INDICATORS AND INVESTMENT

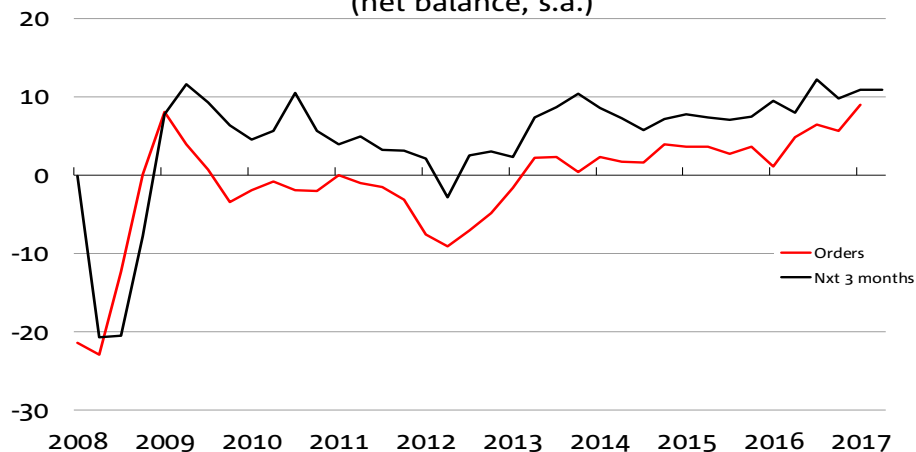
Most leading indicators from the Survey are improving

Business conditions & expectations
(net balance)

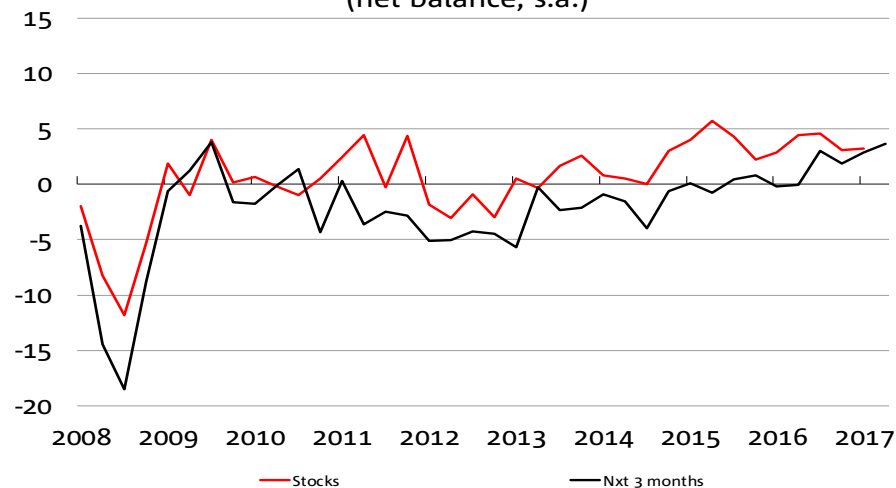


- In the quarterly survey, firms provide responses regarding their expectations for business activity going forward. Firms are overwhelmingly expecting the recent strength in business conditions to continue, with both the near term (3 month) and longer term (12 month) expectations for conditions rising from already elevated levels. Overall, the Survey's leading indicators clearly point to an improving economy, at least in the near-to-medium term, although we remain mindful of potential headwinds, particularly as the dwelling cycle hits its peak and consumers show a degree of restraint. In that context, forward looking indicators for retail from the Survey are worth monitoring. The 12-month ahead expectations for conditions in retail are currently well below their long-run average level and are showing somewhat of a downward trend.
- Expectations for forward orders (3 months ahead) were essentially unchanged at solid levels in Q4. Near-term expectations for profitability also lifted, although longer-term expectations (12-months ahead) are below average.
- Stocks can be another indicator of near-term activity. The stocks index was unchanged in the quarter, and while the long-term trend had shown some gradual improvement in response to better trading conditions and positive orders, it appears to have steadied. Firms had previously been reluctant to restock given uncertainty around the outlook, as well as cost and other competitive pressures. However, we would want to see more of an improvement to definitively indicate a shift in firms attitudes around the outlook.

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



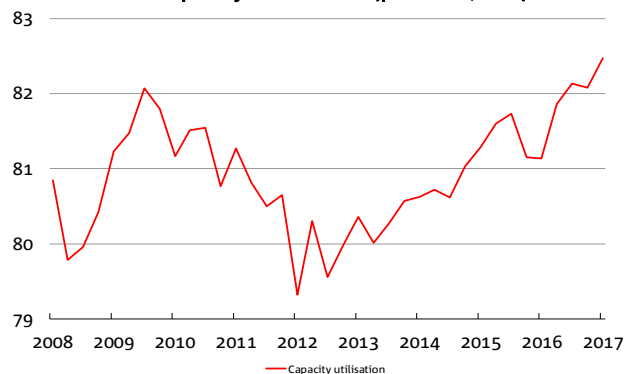
Stocks
(net balance, s.a.)



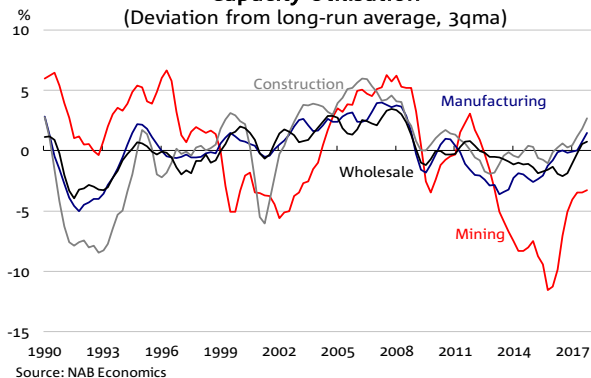
OTHER LEADING INDICATORS & INVESTMENT

Actual investment now catching up to expectations in the NAB Survey

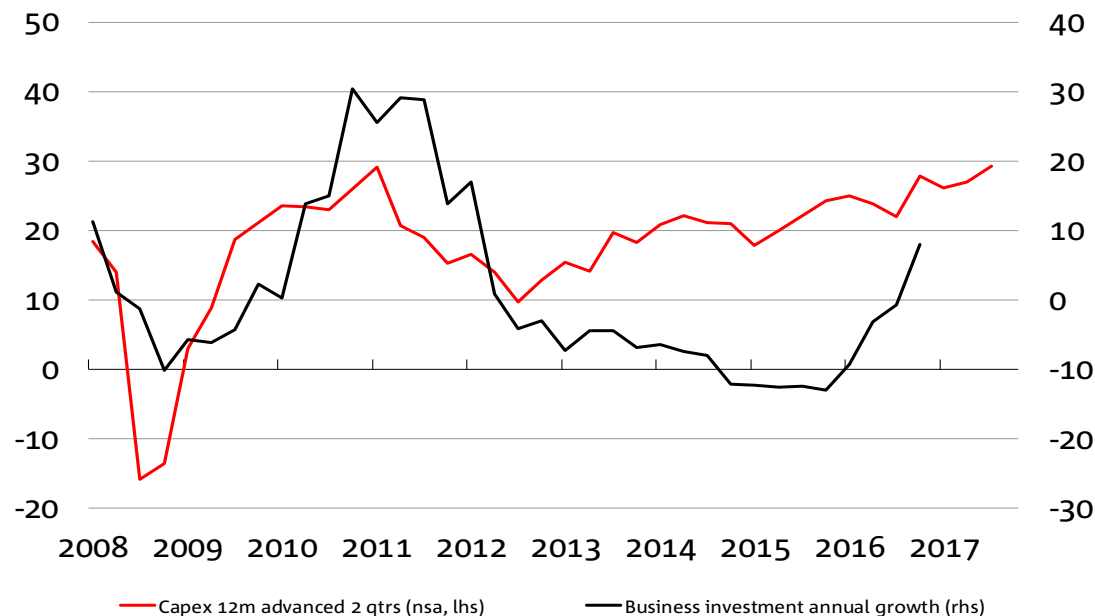
Capacity Utilisation (per cent, s.a.)



Capacity Utilisation
(Deviation from long-run average, 3qma)



Business Investment & Capex Plans

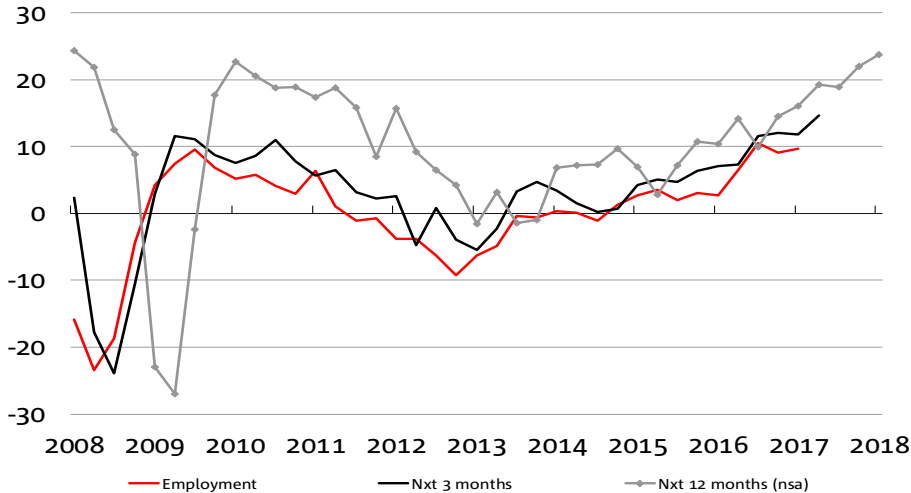


- **Capacity utilisation** rose in Q4, to 82.5%. Mining is the only sector still showing capacity utilisation rates that are well below the long run average (in trend terms), although (like most other industries) it has improved quite significantly, in line with additional commodity production in the final stages of the mining investment cycle. Meanwhile, construction and retail are highest. With capacity utilisation now up from its 2012-13 lows, we are now seeing more clear signs of pass-through to investment decisions, with the capex index from the survey hitting its highest level since 2007. The pass-through to labour demand has been just as apparent in both official ABS statistics and the NAB Survey (see p7).
- **Capital expenditure** in Personal services (up 14) and wholesale (up 12) saw the biggest improvement in capex during the quarter, while construction deteriorated the most (down 15) – despite solid outcomes for the industry elsewhere in the Survey. Nevertheless, the capex index was positive for all industries but retail, and was especially strong in wholesale (+29).
- When asked about their **future capex plans**, firms in the NAB Survey continue to be very upbeat – a trend that is starting to look more apparent in official ABS statistics on investment and capex intentions. While NAB estimates on non-mining investment suggest some acceleration in growth recently, the NAB capex index for the next 12 months suggests we should see even more improvement in the quarters ahead.

LABOUR MARKET

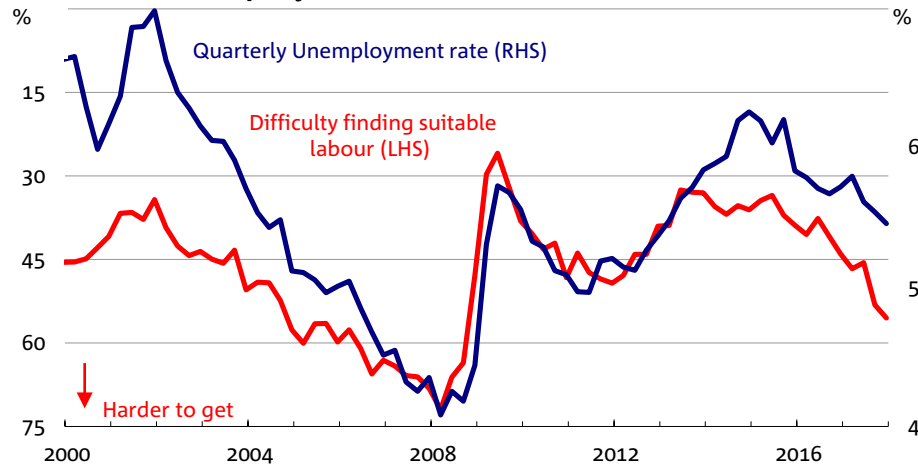
Suitable labour becoming harder to find as the labour market tightens

Employment & expectations (net balance)



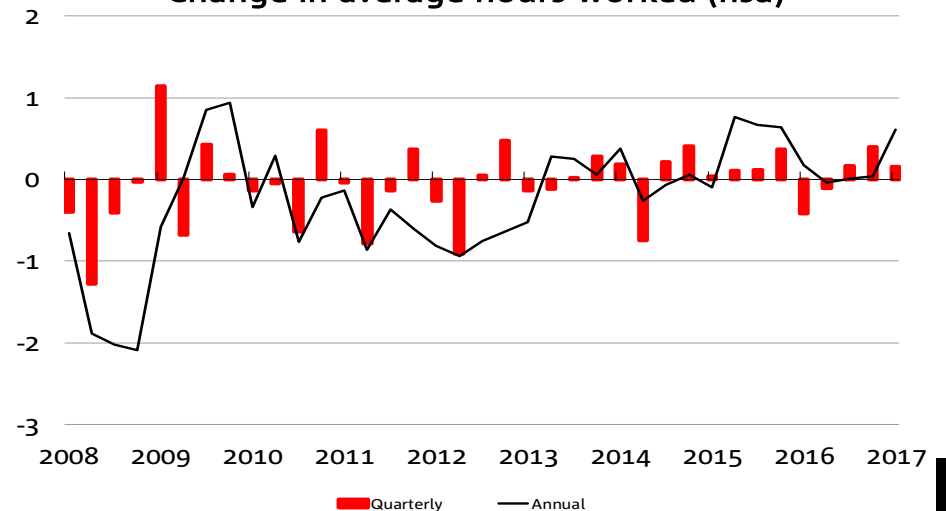
- The employment index from the Survey rose slightly this quarter, keeping the index at relatively elevated levels. The index rose 1 point in Q4, to +10 index points, suggesting rates of employment growth that, if sustained, should lead to additional improvement in the unemployment rate in the near-term. Meanwhile, average hours worked lifted again this quarter.
- Near-term employment expectations rose to +15 index points (from +12), which is above its long-run average. At the same time, longer-term expectations picked-up to multi-year highs. Again, these outcomes suggest that the unemployment rate will ebb lower, with NAB forecasting the unemployment rate to gradually improve to around 5% by end-18.
- In an encouraging sign for future wages growth, firms indicated in Q4 that it became significantly more difficult for them to find suitable labour – there has been a clear trend within the NAB Survey measure since around mid-2015. Given the elevated rate of underemployment in Australia, that result suggests that even though there continues to be a fair degree of slack in the labour market, there may be a deficit of workers with the right skills to match employers' needs.
- However, despite the lack of suitable labour, growth in labour costs failed to ramp up any further in the quarter (p10).

Unemployment rate & labour constraints



Sources: ABS; NAB

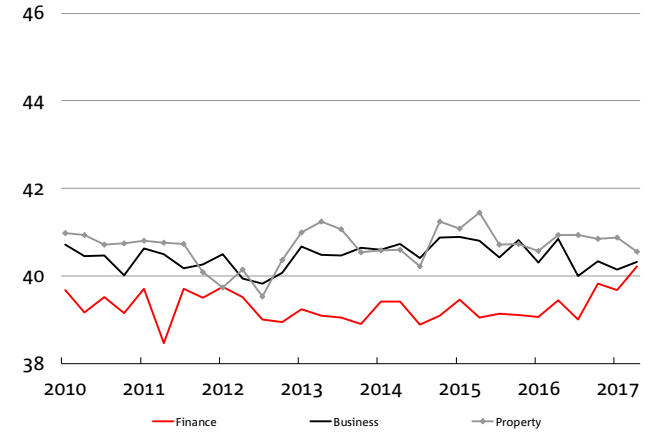
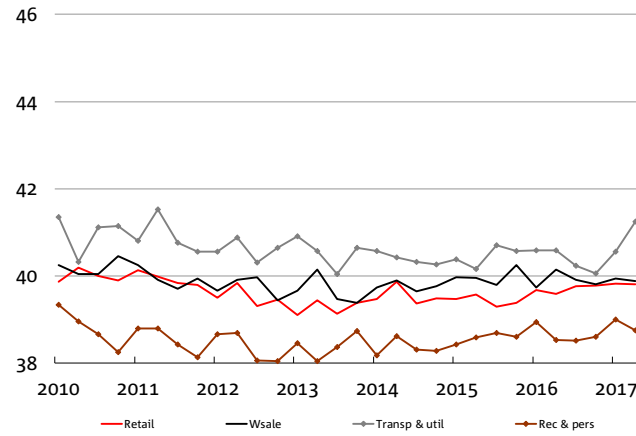
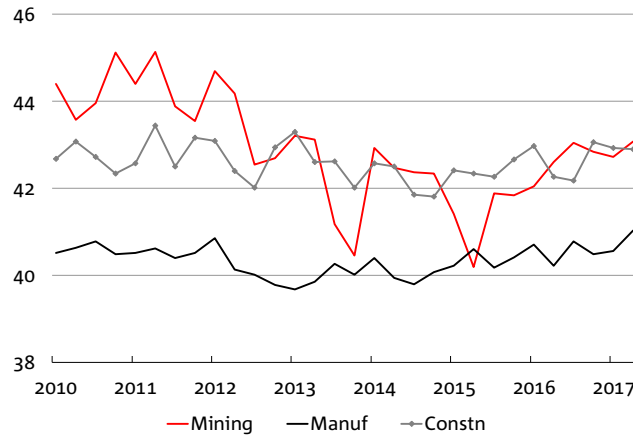
Change in average hours worked (nsa)



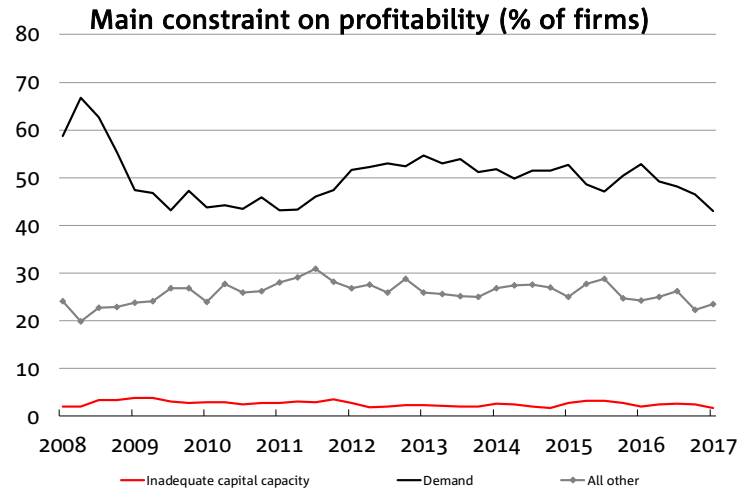
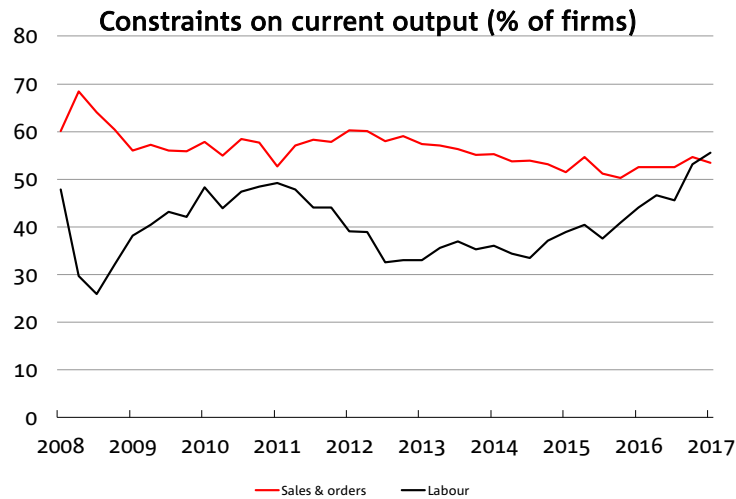
LABOUR MARKET (CONT.)

The lack of suitable labour now a bigger constraint on firms than demand

Average weekly hours worked by industry (nsa)



Major constraints on firm output & profits

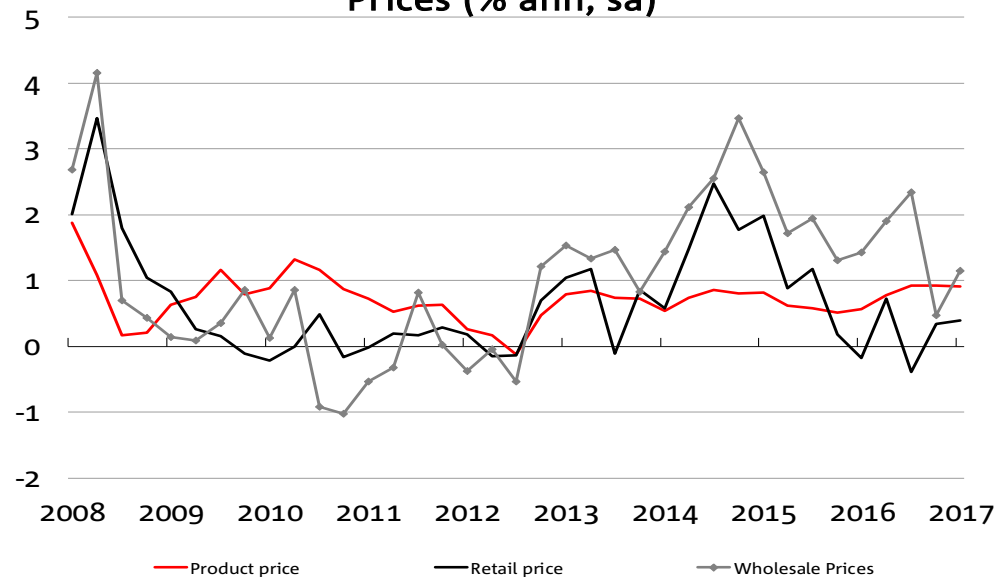


INFLATION PRESSURES

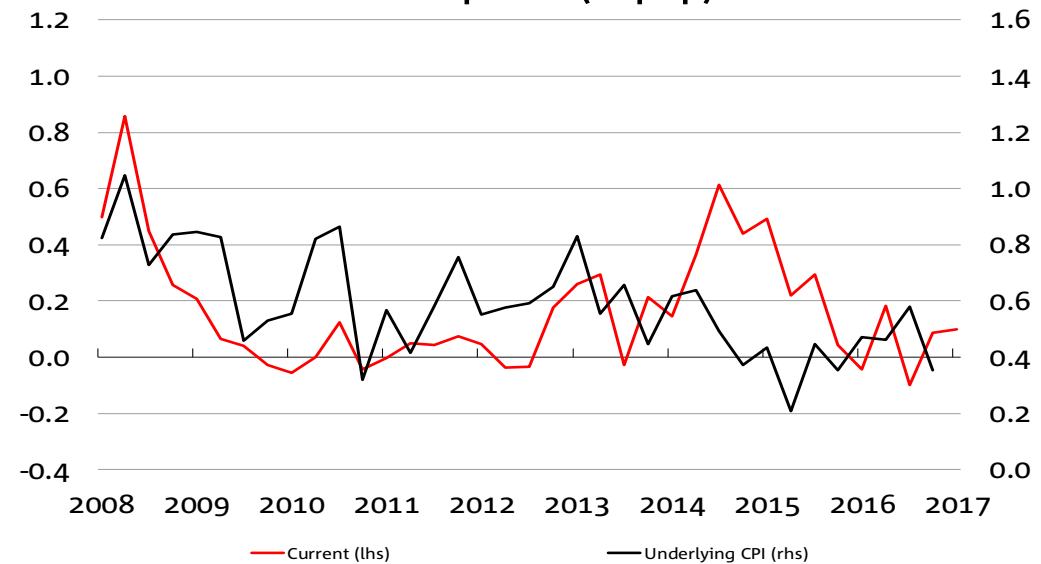
Signs of inflation pressures remain largely elusive

- Growth in final product prices was unchanged at 0.9% annualised and a 0.2% quarterly rate. Both purchase cost and labour cost inflation were running faster than final product price inflation in Q4 (at a quarterly rate of 0.4% and 0.6% respectively). Mining, wholesale and construction each saw an acceleration in price inflation for final products. In levels terms, mining price inflation was strongest in the quarter (0.9%, quarterly rate), followed by wholesale (at 0.3%). In contrast, retail price inflation was weakest at 0.1%. Looking forward, inflation expectations for the next 3 months picked-up slightly, but still suggest that very subdued price pressures will persist, with final price inflation expected to be at around an annualised rate of 1.1% (0.8% for retail inflation).
- With input costs still growing faster than final prices, firms are reporting fairly poor profit margins. The margins index from the survey is in negative territory, although it has improved considerably over the past few years and is back around levels seen prior to the GFC – expectations for the next quarter were also positive, despite easing slightly in Q4. Mining, wholesale, manufacturing and construction all reported positive margins index in Q4 2017 – manufacturing and construction turning positive for the first time in a number of years. Retail is still seeing the worst profit margins, along with transport.

Prices (% ann, sa)



Retail prices (% p.q.)

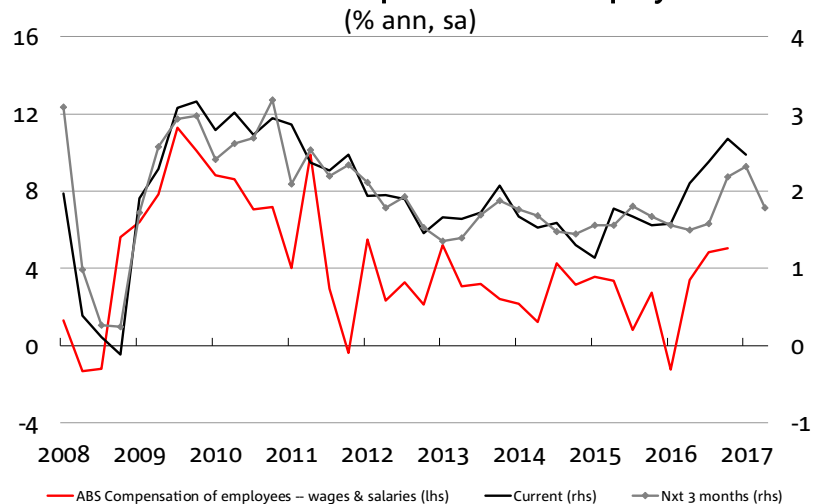


LABOUR COSTS (DETAILS) AND EXPECTATIONS FOR AUD AND RATES

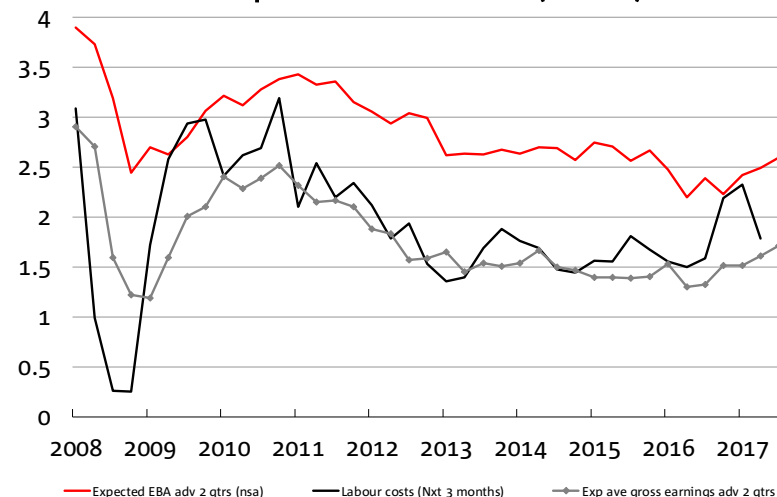
Wage pressures are starting to show signs of life

- Annualised growth in labour costs eased slightly to 2.5% in the quarter (from 2.7%), which is below the series average of around 2.8% since 1989, although this does represent some lift in wage pressures over 2017. That said, the NAB measure is a wage bill measure, meaning solid jobs growth may be contributing to the result as opposed to unit labour costs. Despite a steady lift in the level of employment conditions and reports of greater difficulty finding suitable labour, wage cost pressures have not kept pace with business conditions through this recovery cycle – although are consistent with other measures of slack in the labour market such as the official underemployment rate. The Survey's measures of expectations for labour costs (next 3 months) is not indicating much more momentum in the near term, drop back near the lows of recent years. Wage increases under EBAs are expected to average 2.6% over the next year, or 1.7% after allowing for productivity offsets.
- On average, businesses are now pricing in around a 60% probability of a 25bp rate hike in the next 12-months. NAB Economics' view is that the RBA will see sufficient improvement in the labour market to warrant hiking rates from August this year (see [details](#)). Exchange rate expectations in the Survey (6-months-ahead) dipped to US\$0.76, which is consistent with the level at the time the Survey was taken.

Labour costs & compensation of employees



Expected labour costs (% ann)



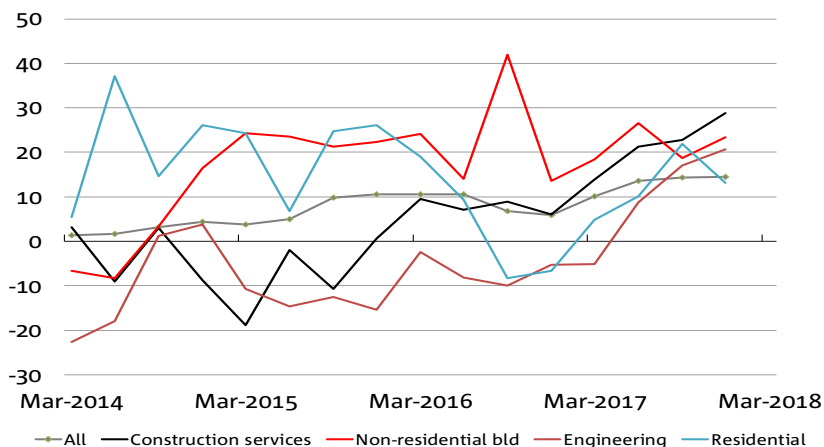
	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	2.3	2.5	3.5	2.3	2.6	1.5	2.7	2.7	2.6
Productivity offset	0.8	1.2	1.3	0.9	0.5	0.5	0.7	1.1	0.9
Net EBA growth	1.5	1.3	2.3	1.4	2.1	1.0	2.0	1.6	1.7

SOME INDUSTRY DETAILS: CONSTRUCTION

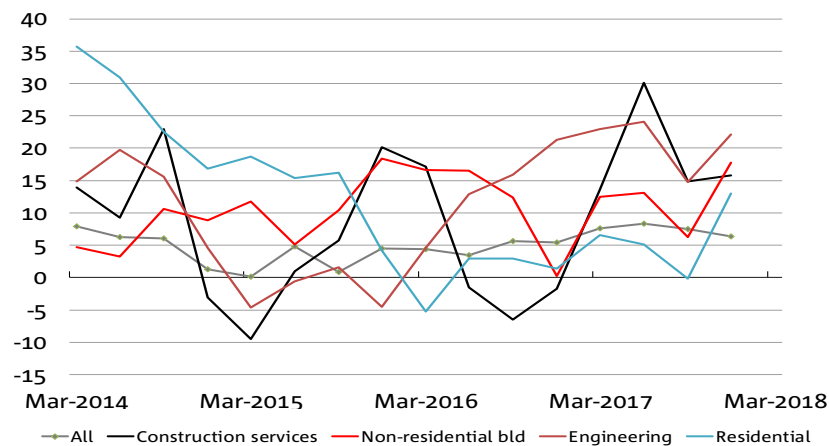
All construction subsectors continue to look solid, despite challenges in residential

- Business conditions for the construction industry rose again from already solid levels in Q4, driven by a lift in all sub-components outside of residential – although residential conditions remain surprisingly elevated too. These trends suggest that concerns around tighter credit conditions and an oversupply of new housing are yet to manifest. Indeed, confidence in residential construction actually rebounded in the quarter. Outside of residential, less drag from mining and large infrastructure spending in some states are supporting engineering firms. Construction services and non-residential construction firms are currently most confident.
- All subsectors are showing positive demand for labour (although trends vary), while capacity is tightening across most sub-sectors (although non-resi is trending down).

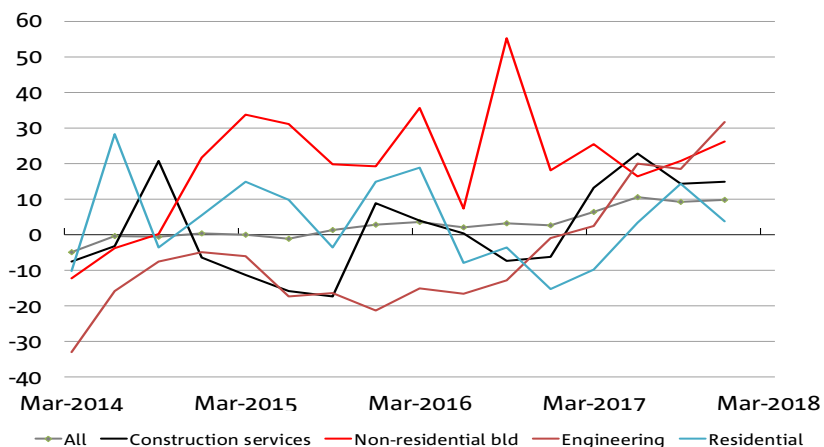
Business conditions by industry



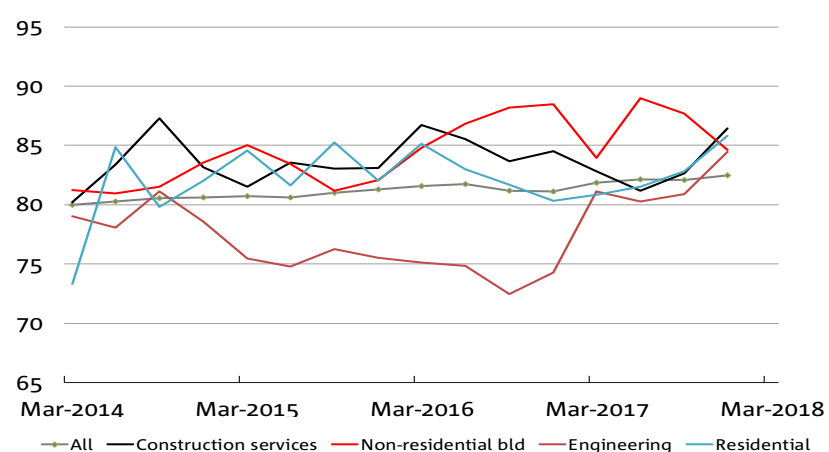
Business confidence by industry



Employment conditions by industry



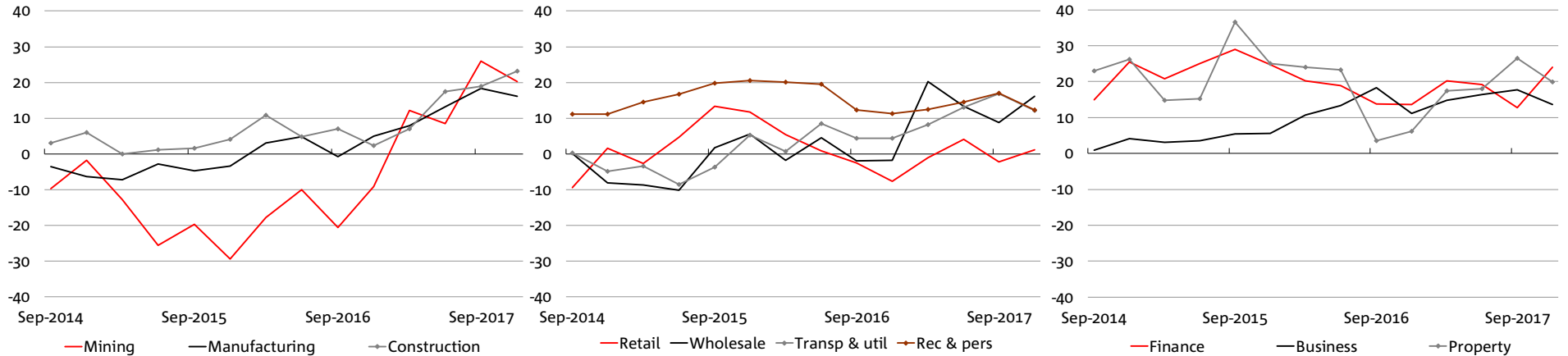
Capacity utilisation by industry



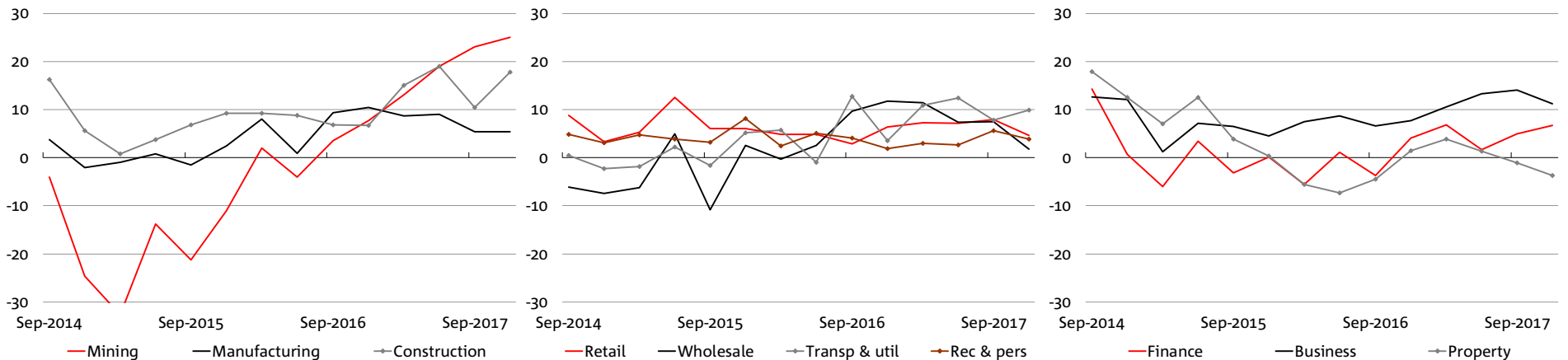
MORE DETAILS ON INDUSTRY

Most industries are looking solid. Retail still lagging, but improved in Q4

BUSINESS CONDITIONS BY INDUSTRY (NET BALANCE)



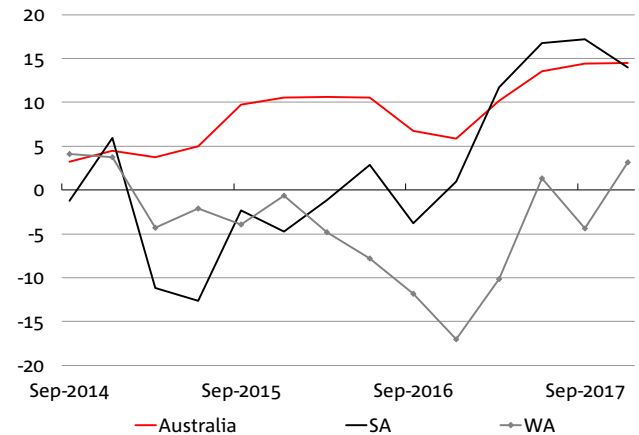
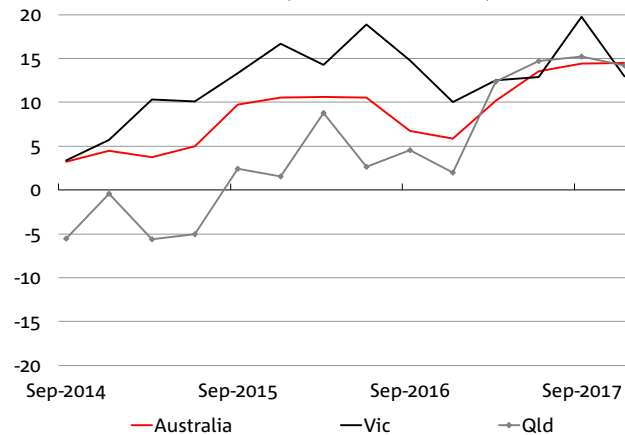
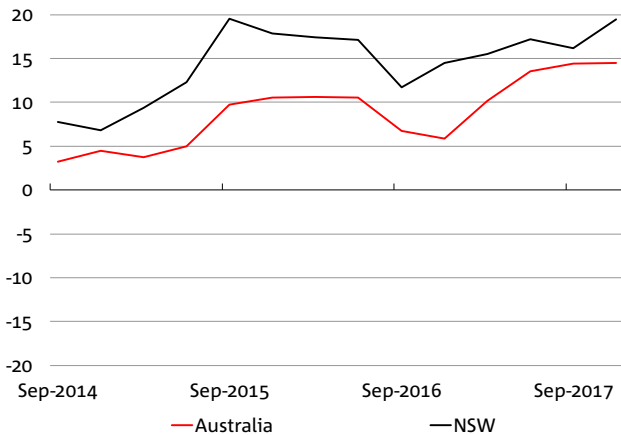
BUSINESS CONFIDENCE BY INDUSTRY (NET BALANCE)



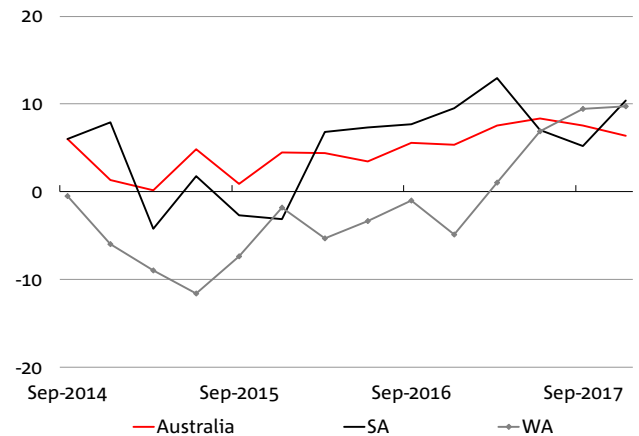
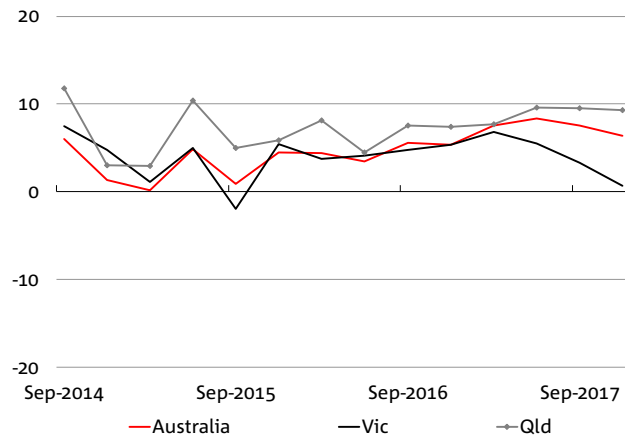
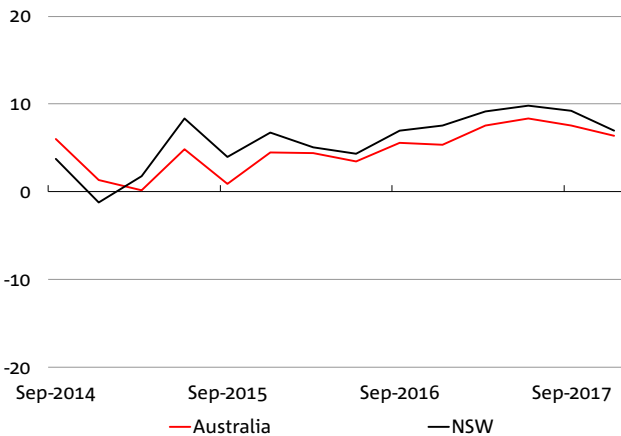
MORE DETAILS ON STATE

Most states are enjoying solid business conditions, but WA is soft

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



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



DATA APPENDIX

	Quarterly					Monthly				
	2016q4	2017q1	2017q2	2017q3	2017q4	2017m8	2017m09	2017m10	2017m11	2017m12
Confidence	5	8	8	8	6	6	8	9	7	11
Conditions	6	10	14	14	15	15	15	20	13	13

	Quarterly					Monthly				
	2016q4	2017q1	2017q2	2017q3	2017q4	2017m8	2017m09	2017m10	2017m11	2017m12
Trading	9	14	18	19	18	19	19	29	17	18
Profitability	5	11	12	15	15	17	18	26	14	15
Employment	3	6	11	9	10	10	7	7	7	6

	Quarterly ^(a)					Monthly				
	2017q3	2017q4	2018q1	2018q3	2018q4	2017m8	2017m09	2017m10	2017m11	2017m12
Conditions	14	15				15	15	20	13	13
Conds. next 3m	22	21	24							
Conds. nxt 12m	25	24	28	28	31					
Orders	6	9				4	5	3	6	4
Orders next 3m	10	11	11							

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

	Quarterly ^(a)					Monthly				
	2017q1	2017q2	2017q3	2017q4	2018q1	2017m8	2017m09	2017m10	2017m11	2017m12
Capacity utilis.	81.9	82.1	82.1	82.5		81.6	81.9	81.7	81.7	82.2
Stocks current	4	5	3	3		0	4	2	2	1
Stocks next 3m	0	3	2	3	4					

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

	2016q4	2017q3	2017q4		2016q4	2017q3	2017q4
	Constraints on output (% of firms)*					Main constraints on profitability (% of firms)*	
Sales & orders	52.4	54.7	53.4	Interest rates	1.3	2.9	2.0
Labour	45.5	53.1	55.5	Wage costs	11.1	12.3	13.9
Premises & plant	22.9	26.2	26.3	Labour	10.6	11.8	12.3
Materials	11.5	12.0	13.3	Capital	2.7	2.5	1.8
				Demand	48.1	46.4	43.1
				All other	26.2	22.3	23.5

* not s.a.

DATA APPENDIX

	Quarterly ^(a)					Monthly				
	2017q3	2017q4	2018q1	2018q3	2018q4	2017m8	2017m09	2017m10	2017m11	2017m12
Empl current	9	10				10	7	7	7	6
Empl next 3m	12	12	15							
Empl nxt 12m	15	16	19	22	24					

(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	2.5	3.5	2.3	2.6	1.5	2.7	2.7	2.6
Productivity offset	0.8	1.2	1.3	0.9	0.5	0.5	0.7	1.1	0.9
Net EBA growth	1.5	1.3	2.3	1.4	2.1	1.0	2.0	1.6	1.7

State Tables

	Quarterly					Monthly				
	2016q4	2017q1	2017q2	2017q3	2017q4	2017m8	2017m09	2017m10	2017m11	2017m12
Business conditions										
NSW	14	15	17	16	19	16	18	30	16	11
VIC	10	13	13	20	13	25	16	16	12	11
QLD	2	12	15	15	14	12	13	14	13	23
SA	1	12	17	17	14	25	20	15	15	6
WA	-17	-10	1	-4	3	-3	0	4	2	15

	Quarterly					Monthly				
	2016q4	2017q1	2017q2	2017q3	2017q4	2017m8	2017m09	2017m10	2017m11	2017m12
Business confidence										
NSW	8	9	10	9	7	10	6	10	8	8
VIC	5	7	5	3	1	5	7	7	-2	14
QLD	7	8	10	9	9	8	15	10	9	13
SA	10	13	7	5	10	4	7	13	13	6
WA	-5	1	7	9	10	8	9	6	11	4

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

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

James Glenn
Senior Economist – Australia
+61 4)55 052 519

Amy Li
Economist – Australia
+61 3) 8634 1563

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

Behavioural & Industry Economics

Dean Pearson
Head of Behavioural & Industry Economics
+61 3) 8634 2331

Robert De lure
Senior Economist – Behavioural & Industry Economics
+61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+613) 9208 2929

International Economics

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

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

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

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

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

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

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy

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

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy

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

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution

Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand

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

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Jason Wong
Currency Strategist
+64 4 924 7652

Caroline Down
Publications & Web Administrator
+64 4 474 9771

Asia

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

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

UK/Europe

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Please click [here](#) to view our disclaimer and terms of use.

