

# A SPECIAL REPORT ON WHY BUSINESS CONDITIONS HAVE WEAKENED SIGNIFICANTLY RECENTLY



*Based on responses from the November 2018 Monthly Business Survey*

## OVERVIEW

Over the course of 2018 reported business conditions in the Monthly and Quarterly Business Surveys have weakened significantly. While still above long run average readings the trend down in business conditions has been quite sharp and continuous. It has also spread to other key responses in the Survey – so for the first time since early 2016 both business confidence and forward orders have now fallen below long run average readings. We are often asked why? Rather than just speculate on possible causes we have asked respondents to give their views as to possible reasons for the weakening of business conditions. The first question asked respondents to nominate the most likely reason(s) for this trend – choosing from a long list of possible causes. Secondly, given the widespread interest in possible flow on effects of falling house prices in Sydney and Melbourne we asked a set of specific questions on whether respondents had seen an impact from falling house prices on the demand from their customers. For the latter we used a scale (similar to that used in the past on other issues such as tax policy and wage movement) ranging from significant impacts to, moderate impact, somewhat of an impact, and nothing.

The results can be split by industry, size and by geographic region.

While there are more details below, key findings can be summarised as follows:

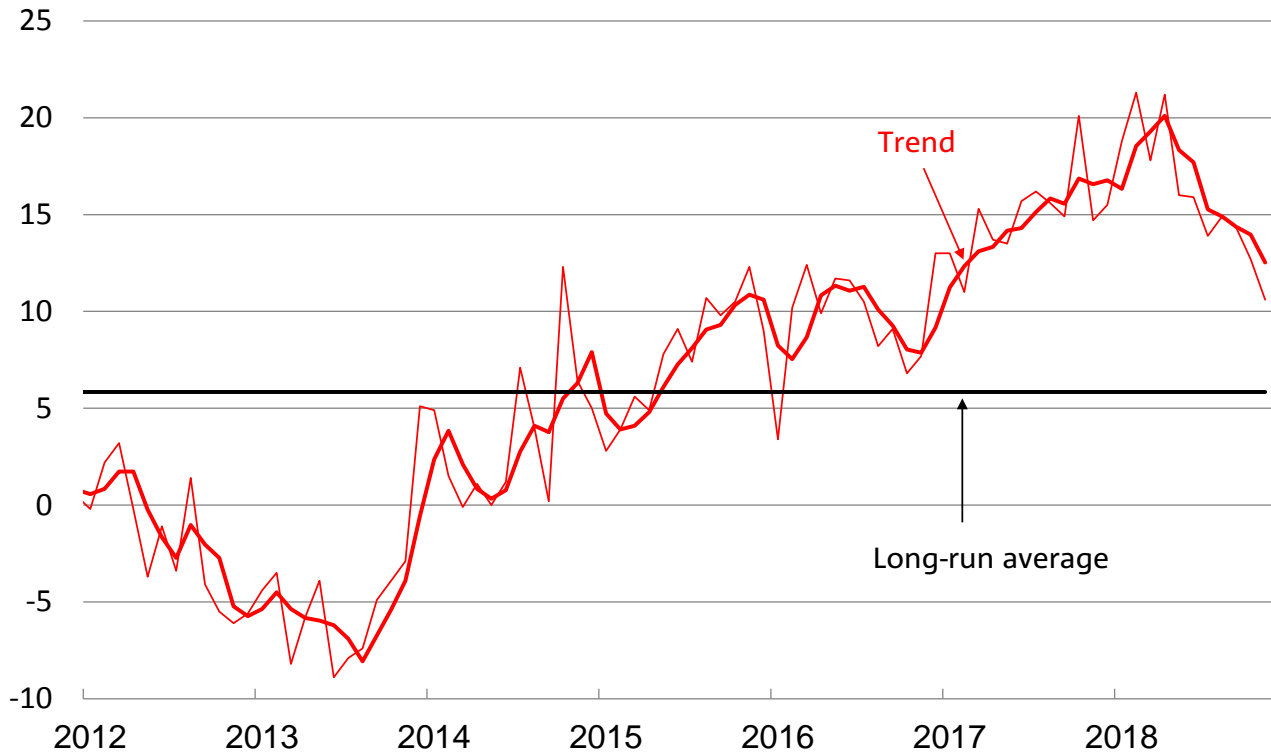
- Respondents rated issues such as consumer demand, high wages cost levels, margin pressure and difficulties in obtaining suitable labour as key issues. House prices and fuel costs were not rated as key issues (12<sup>th</sup> and 11<sup>th</sup> issues of importance out of a possible 17 potential problem issues).
- There were, however, some specific issues impacting particular industries more than others. That included: consumer demand in retailing; wage costs in personal and recreational services; global political uncertainties and inability to obtain suitable labour in mining; fuel prices in transport; and currency effects in wholesaling.
- Within those listing house price as a problem the highest reads were in wholesale and retail (but even there the levels of concern were relatively low).
- Of course it could be that falling customer demand (the number one ranked issue) really reflected household balance sheet constraints – and hence house prices (and possibly fuel prices as well) entered indirectly in responses. Accordingly another question specifically on the impact of falling house prices on customer demand was included.
- On the impact of house prices specifically the responses were again relatively subdued. Around 75% of respondents reported no impact. And only 9% reported a mild “somewhat” effect and around 3% a “moderate” negative impact.
- And not surprisingly those reporting “somewhat” of a negative impact from house price falls were largest in wholesaling and retailing.
- All of this is not to deny that asset prices can, if they fall far enough, have significant economic effects. Rather the key message seems to be that, so far in a good performing economy (boosted by public demand, commodity exports and better business investment) the falls in house prices are not yet sufficient to cause serious grief across the broader economy.

## THE EXTENT OF THE SLOWING IN BUSINESS CONDITIONS:

As noted above, while still reporting above long run averaging reading, business conditions has slowed significantly over recent times. The extent of the slowing is shown in the following chart.

### Business Conditions

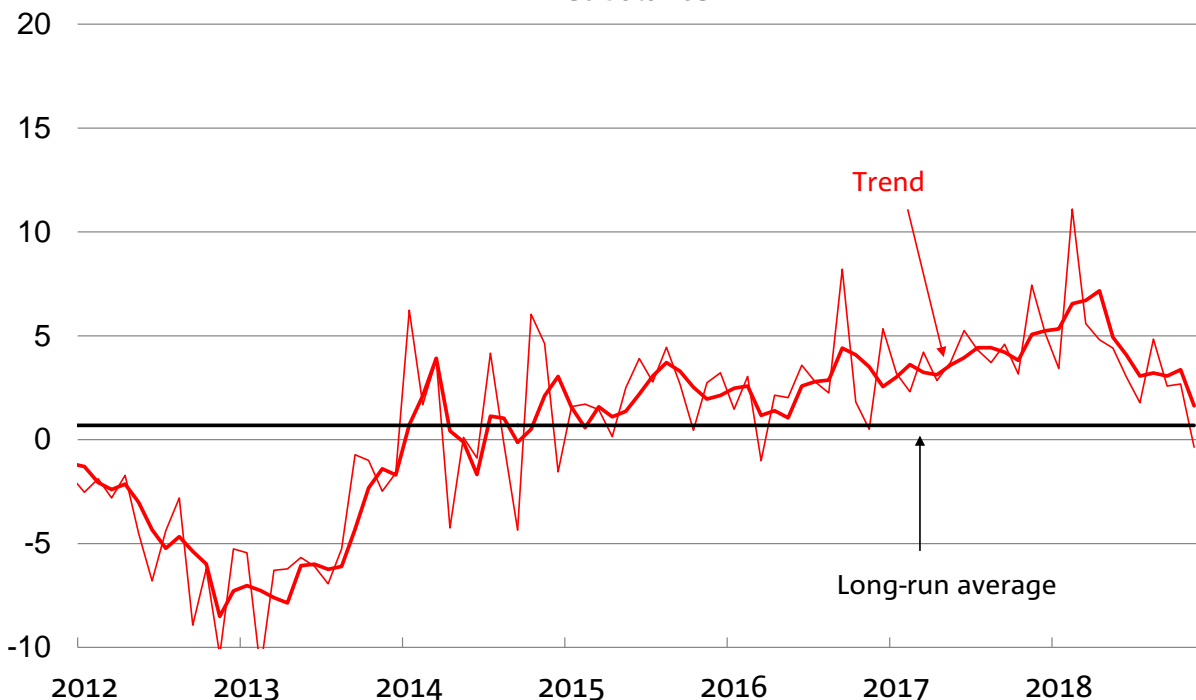
Net balance



And as noted above, current readings for the first time in a number of years for business confidence and forward orders are below long run averages. The latter is also important as we believe it provides the best read from the Survey of what is actually happening in the domestic (private sector) economy – see chart.

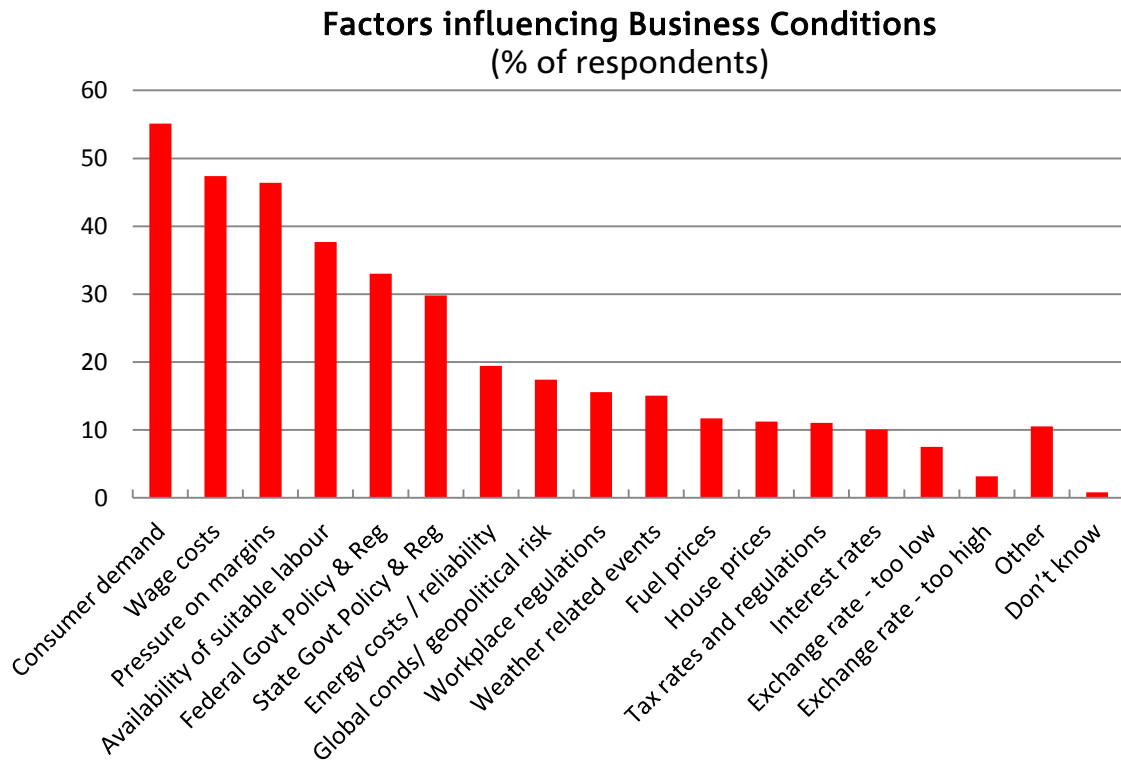
### Forward Orders

Net balance

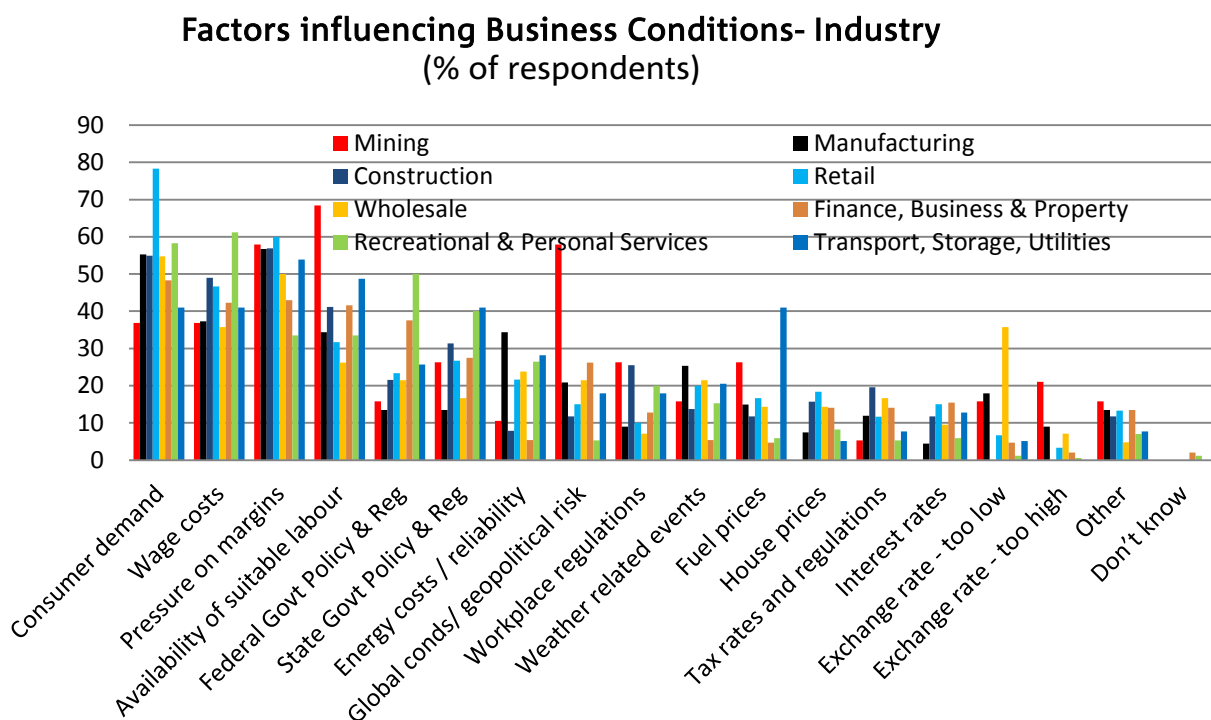


# BUSINESS RESPONSES TO WHY BUSINESS CONDITIONS HAVE SLOWED RECENTLY

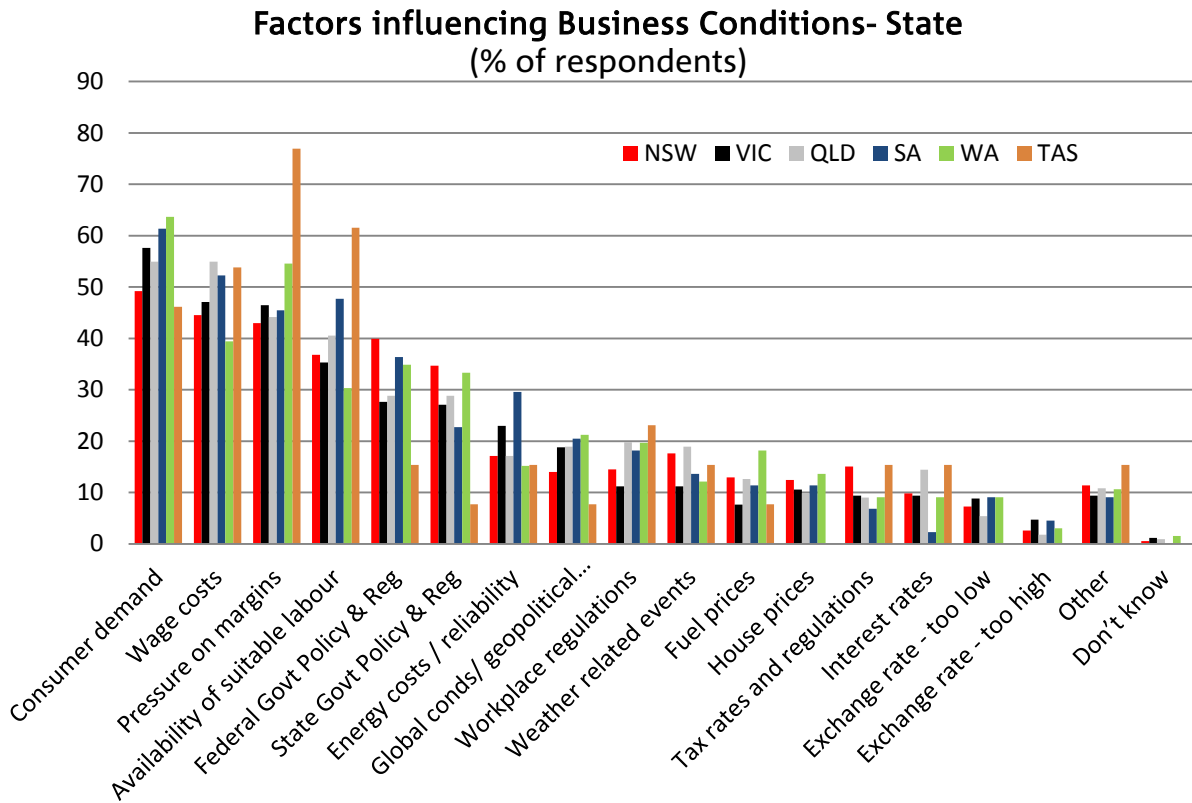
In response to this slowing respondents were asked to nominate the factor(s) behind this trend. They could nominate more than one issue. The results are summarised in the attached chart – which ranks the issues by importance (that is adding up the responses).



By industry, the same general trends were observed but as noted above there were a number of outliers by particular industry. As shown below, that included: consumer demand in retailing; wage costs in personal and recreational services; global political uncertainties and inability to obtain suitable labour in mining; fuel prices in transport; and currency effects in wholesaling. Of those industries listing house price as a problem the highest reads were in wholesale and retail (but even there the levels of concern were relatively low)

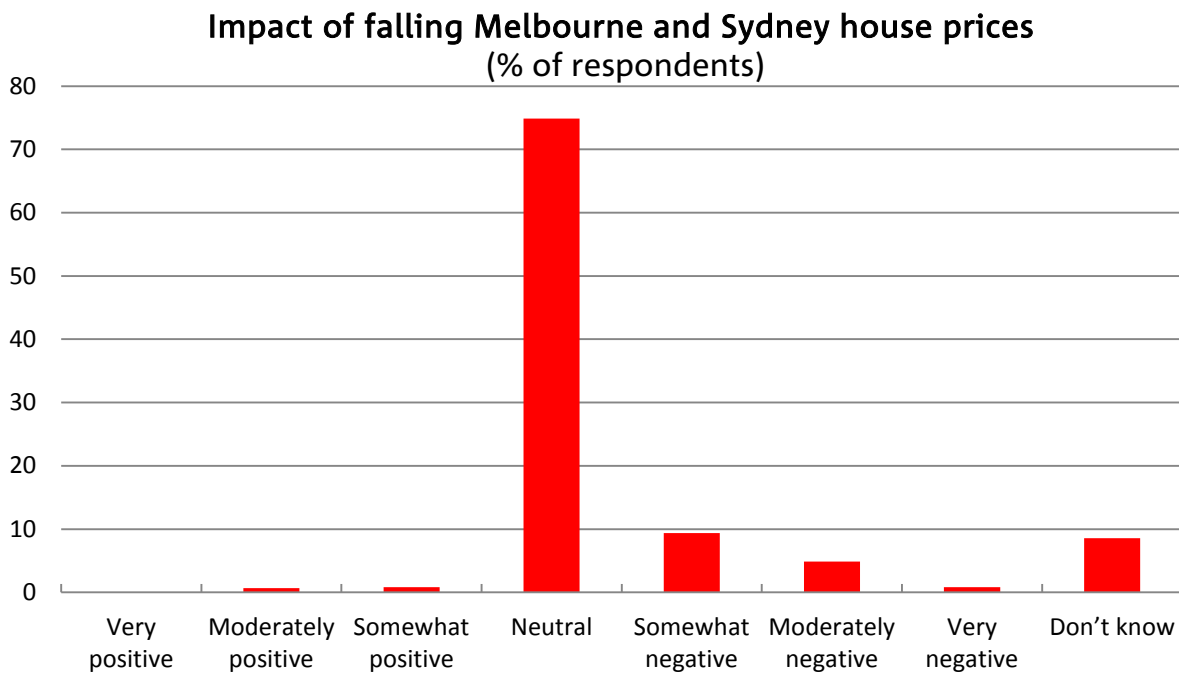


Nor were there significant differences across regions – albeit margin pressures and attracting suitable labour appear a more acute problem in Tasmania.



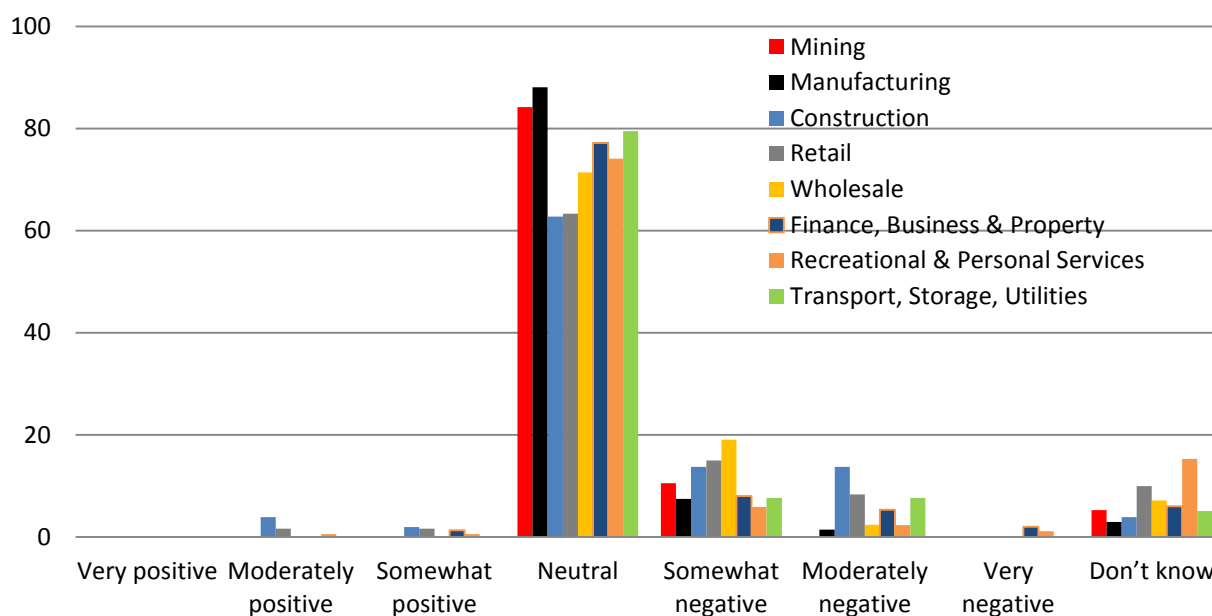
## ARE HOUSE PRICE FALLS IN SYDNEY/ MELBOURNE AFFECTING YOUR FIRM' BUSINESS CONDITIONS

As noted above we also explored the possibility that house prices were indirectly affecting business conditions by reducing customer demand. To do this we asked a specific question about whether house price falls in Sydney/ Melbourne were impacting demand. A surprisingly large proportion of the sample said they didn't see any evidence of that – as shown by the following chart



And by industry the results were similar:

### Impact of falling Melbourne and Sydney house prices - Industry (% of respondents)



The chart does however show some moderate differences across industry – with wholesaling and retail expressing the most (albeit moderate) concerns.

It is important to note that all of this is not to deny potential scope for large negative flow on effects from substantial falls in asset prices (house prices and equities). However to date business seems relaxed as to the implications of what has happened so far. A number of points are relevant here. First the falls to date need to be put in the context of large increases in previous years (compared to 4 years ago house prices are still up 25% and 35% respectively in Sydney and Melbourne). Also the recent falls are really only a Sydney/Melbourne issue. Also internal modelling we have done suggests that the combination of highly stimulatory monetary policy settings, high commodity prices and a strong US/global environment (not to mention very strong public sector spending) have so far more than offset wealth effects from lower asset prices.

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