National Australia Bank

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Quarterly Business Survey

March quarter 2013

Business confidence lifts from late 2012 lows but still below average. That reflects better global confidence, stronger equity prices and lower borrowing rates at home. Conditions still subdued and with marked weakness in trade and consumer dependent sectors. Forward indicators and medium-term expectations still very poor. Capex expectations imply flat investment (falling in non-mining). Low price pressures imply soft Q1 core inflation.

- Business confidence improved significantly in the March quarter – the first quarterly rise in sentiment since December 2011. That said confidence still remains below long-run average levels. Much of the improvement in confidence reflects the unwinding of concern surrounding a number of external risks, including the US fiscal cliff, a hard landing in China and the reduced risk of a further European crisis. While equity price rises and lower borrowing rates are also likely to have helped, it appears the still high AUD remains concerning for the trade dependent industries.
- Business conditions strengthened modestly in the March quarter, after weakening to their lowest level since June quarter 2009 in the previous survey. That said, business conditions are still clearly signaling below trend growth. Indeed, the NAB quarterly business survey points to domestic demand growth in March quarter 2013 of around 2¼%. More worrying forward indicators of demand remain subdued – notably forward orders, stocks and capital expenditure – suggesting activity will soften into the June quarter. There are indeed signs of that happening in the March Monthly Business Survey.
- The improvement in business conditions is almost entirely attributable to two industries; finance/ business/ property, which probably gained from rising equity prices and easier financial conditions, while lower borrowing rates appear to have helped to strengthen construction activity. Consumer and trade dependent sector conditions remained weak, implying that either lower interest rates need more time, or more stimulus (eg. RBA rate cuts) are needed to strengthen consumer demand. Conditions were little changed across mainland states in Q1, with the exception of Queensland, where they lifted considerably.
- Business investment intentions (next 12 months) lifted a touch in Q1 but remained low relative to outcomes a year or two ago. Indeed, they imply flat investment growth over the next 12 months. This is consistent with NAB's expectation for non-mining investment to take time to fill the approaching 'gap' from a slowing in mining investment. Near and longer term employment expectations ticked up but point to more labour market weakness. Lack of demand is expected to be the most significant factor impacting profitability over the next 12 months and concerns about tax & government policy remain important.
- Product price inflation remained subdued, recording annualised growth of just 0.2%. Retail price inflation was also soft and implies a soft March quarter underlying inflation outcome. Labour and purchase costs growth remained modestly below-average levels.

Implications for NAB forecasts:

- No change to latest Global and Australian Forecasts (released 9 April).

Key quarterly business statistics**

	2012q3	2012q4	**2013q1**		2012q3	2012q4	**2013q1**
		Net balance				*Net balance*	
Business confidence	-3	-5	**2**	Trading	5	-3	**0**
Business conditions				Profitability	-1	-8	**-4**
Current	0	-5	**-2**	Employment	-2	-3	**-2**
Next 3 months	5	-1	**5**	Forward orders	-4	-8	**-7**
Next 12 months	17	11	**17**	Stocks	3	-1	**-3**
Capex plans (next 12)	14	10	**13**	Exports	-1	-2	**-1**
		% change				*% change*	
Labour costs	0.6	0.5	**0.4**	Retail prices	0.1	0.0	**0.0**
Purchase costs	0.5	0.3	**0.3**			*Per cent*	
Final products prices	0.2	0.1	**0.1**	Capacity utilisation rate	80.7	79.4	**80.3**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 25 February to 13 March 2013, covering over 900 firms across the non-farm business sector.

For more information contact:
Alan Oster, Chief Economist
(03) 8634 2927 0414 444 652

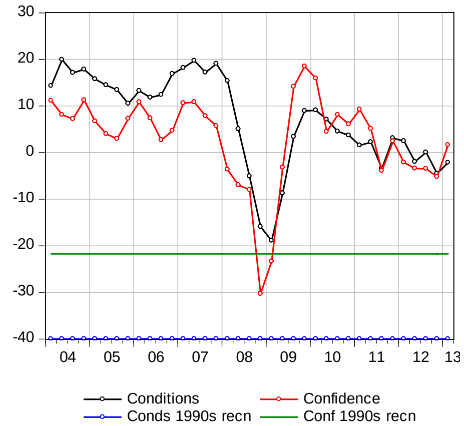
Next release:
13 May 2013 (April Monthly)

Analysis

Business confidence improved significantly in the March quarter – up 7 points to +2 index points – after recording the weakest outcome in almost four years in the previous quarter. The lift in confidence in the March quarter is the first quarterly rise since December 2011. While businesses appear much more confident in the current period compared to at the end of last year, much of this reflects the unwinding of concern surrounding a number of external risks, including the US fiscal cliff and a hard landing in China. Since then, equity markets have strengthened and lower borrowing rates appear to be helping to strengthen consumer demand; these factors, as well as less perceived risk of a European crisis (survey conducted prior to events in Cyprus) appear to have helped to strengthen confidence in the March quarter. Nonetheless, at +2 points, business confidence is still below the long-run average of +4 points since 1989. Confidence readings in the quarterly business survey were broadly consistent with monthly survey readings.

Conditions pick up from very low level reported at the end of 2012

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



Confidence = excluding normal seasonal changes, how do you expect the business conditions facing your industry in the next 3 months to change?

Conditions = average of the indexes of trading conditions, profitability and employment.

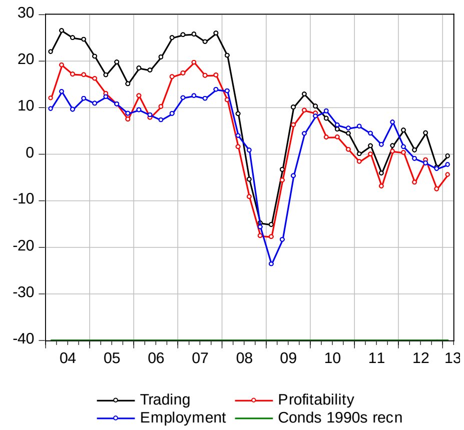
Business conditions strengthened a touch in the March quarter, after slumping to their weakest level since June quarter 2009 in the previous quarter. But while the quarterly index improved, the monthly data indicate a worsening trend through the course of Q1.

	Quarterly					*Monthly*				
	2012q1	2012q2	2012q3	2012q4	**2013q1**	2012m11	2012m12	2013m1	2013m2	2013m03
Confidence	-2	-3	-3	-5	**2**	-9	3	3	1	2
Conditions	2	-2	0	-5	**-2**	-5	-5	-2	-3	-7

The **business conditions** index improved modestly in the March quarter (up 3 to -2 points), though it remained below the series long-run average level of +1 point (since 1989). The strengthening in activity reflected broad-based improvements in profitability, trading and employment conditions. Conditions increased sharply in construction and finance/ business/ property, while retail and wholesale were the only industries to report (a marginal) deterioration in activity – where activity remained weak. The weakness in retail conditions is at odds with official ABS data, which suggests retail trade strengthened considerably in the first two months of this year. Outcomes from this survey imply that either lower interest rates need more time, or more stimulus (eg. RBA rate cuts) may be needed to strengthen consumer demand.

Activity measures improve, but still relatively poor

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

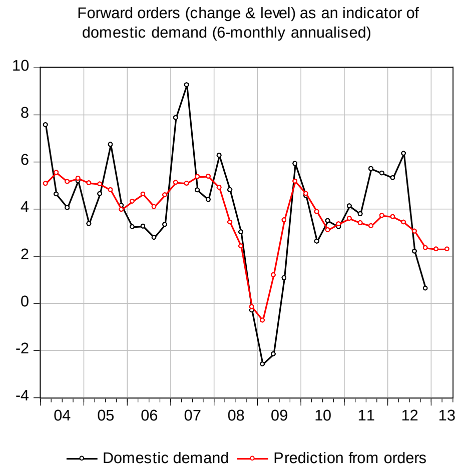


Net balance of respondents who regard last 3 months' trading / profitability / employment performance as good.

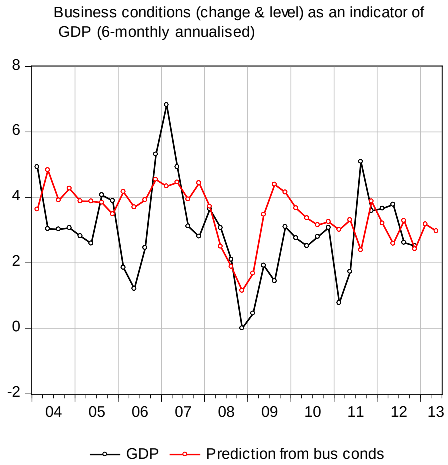
	Quarterly					*Monthly*				
	2012q1	2012q2	2012q3	2012q4	**2013q1**	2012m11	2012m12	2013m1	2013m2	2013m03
Trading	5	1	5	-3	**0**	-2	-5	0	0	-4
Profitability	0	-6	-1	-8	**-4**	-9	-8	-3	-6	-6
Employment	2	-1	-2	-3	**-2**	-5	-3	-6	-3	-5

Analysis (cont.)

Demand growth to remain soft



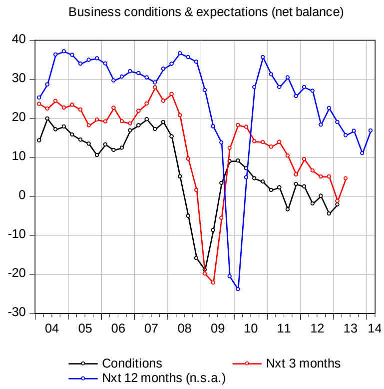
GDP growth to strengthen into 2013



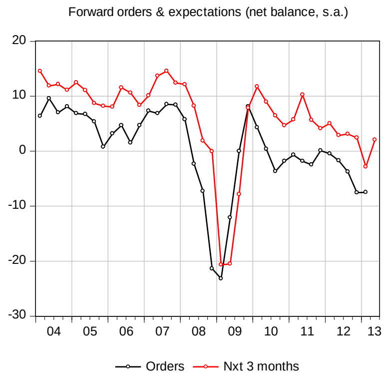
Based on forward orders in the March quarter, the survey implies that 6-monthly annualised demand growth was a subdued 2¼% in the March quarter. If we assume forward orders for the March quarter are continued into the June quarter, the survey implies 6-monthly annualised demand growth will remain close to this level (of 2¼%). Similarly, based on historical relationships, the survey implies that 6-monthly annualised demand growth strengthened to around 3¼% in the March quarter. But if March quarter business conditions are maintained into the June quarter, the implied growth rate would slow to around 3%.

Analysis (cont.)

Expectations improve but still weak



Orders still very weak

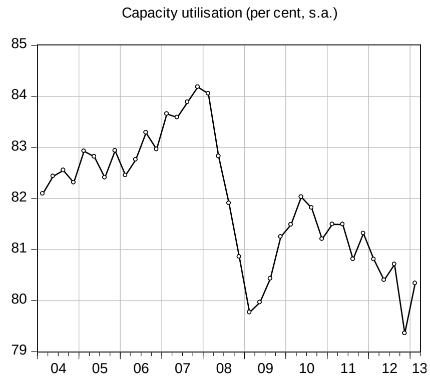


Consistent with actual conditions, short and long-term expectations for business conditions picked up in the March quarter, though remained subdued overall and clearly below average levels. The level of forward orders stabilised at a low level in the March quarter, following a string of quarterly declines. Near-term expectations for orders improved in the March quarter, consistent with the expected strengthening in near-term trading activity.

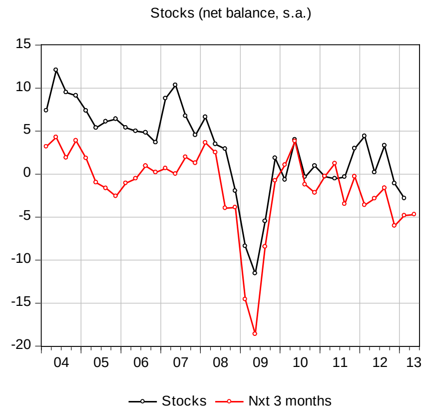
	Quarterly (a)					*Monthly*				
	2012q4	2013q1	2013q2	2013q4	2014q1	2012m11	2012m12	2013m1	2013m2	2013m03
Conditions	-5	**-2**				-5	-5	-2	-3	-7
Conds. next 3m	5	-1	**5**							
Conds. nxt 12m	23	19	16	11	**17**					
Orders	-8	**-7**				-9	-5	-5	-11	-5
Orders next 3m	2	-3	**2**							

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

Capacity utilisation improves but still low



Stocks trend lower, and to remain depleted



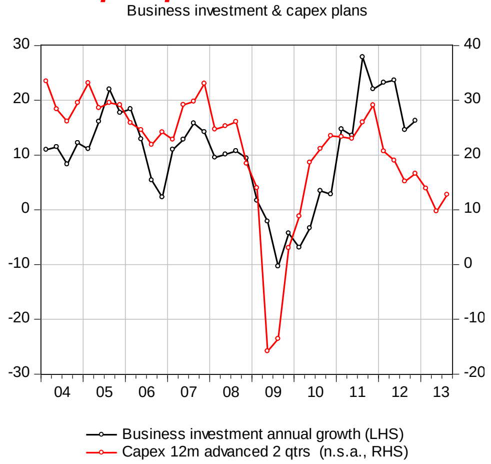
Capacity utilisation lifted solidly in the March quarter, partly unwinding a heavy decline in the December quarter. The current rate, at 80.3%, is 0.3 ppts below the series long-run average (of 80.6% since 1989). Expectations for stocks (over the next three months) were unchanged at a low level, implying little near-term improvement in domestic demand. This outcome is consistent with a still below-average (albeit improved) near-term outlook for trading activity.

	Quarterly (a)					*Monthly*				
	2012q2	2012q3	2012q4	2013q1	2013q2	2012m11	2012m12	2013m1	2013m2	2013m03
Capacity utilis.	80.4	80.7	79.4	**80.3**		79.5	79.7	79.4	79.9	79.9
Stocks current	0	3	-1	**-3**		-4	-2	-2	-4	0
Stocks next 3m	-3	-2	-6	-5	**-5**					

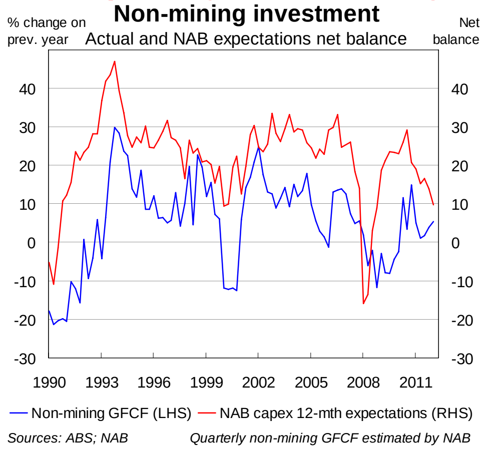
(a) Quarter to which expectation applies. All data are seasonally adjusted.

Analysis (cont.)

Capex plans still weak…



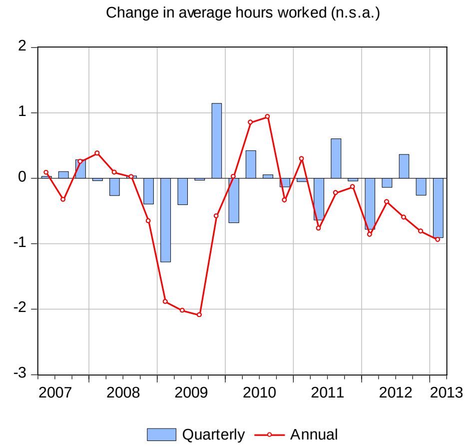
…especially in non mining



The NAB survey measure of business capital expenditure continues to point to a further deterioration in business investment growth in the next six to 12 months, with the March quarter outcome implying little to no expected business investment. Nonetheless, expectations in the March quarter improved a touch from expectations in the previous quarter. The expected softening in investment growth is consistent with declines in commodity prices, which have brought into question the viability of a number of prospective mining projects (with mining investment making up the lion's share of total business investment in Australia over recent years). A number of mining firms have confirmed their intentions to either scale back capacity or defer projects in the current soft price environment. While the approaching of the peak in mining investment is expected to see total business investment activity soften over the next year, the value of mining investment is expected to remain at historically elevated levels. There are, however, no signs of accelerating-non mining investment which would be needed to offset the falls in mining investment that lay ahead.

Near-term employment expectations improve but still weak

Average hours fall, again



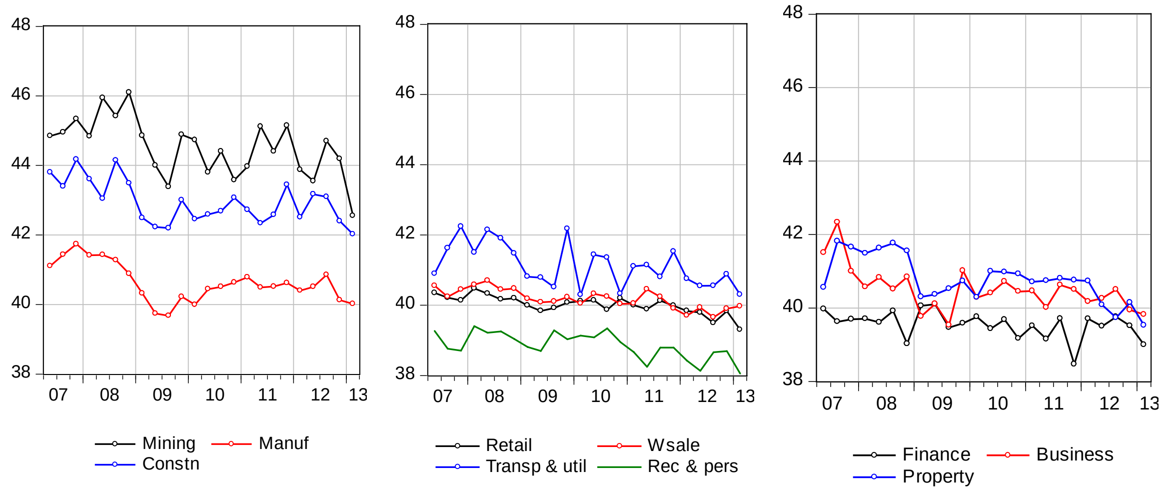
The employment index improved marginally to -2 index points in the March quarter, though remained below the long-run average of zero points since 1989. Employment expectations also strengthened in the March quarter, though they remained relatively subdued when compared to average expectations throughout the post-GFC period.

Average hours worked fell heavily in the March quarter – down from 40 hours per week to 39.7 hours per week – consolidating a soft decline in the previous quarter. While the reduction in average hours implies employers are continuing to retain heads where possible, when combined with a negative reading for employment conditions, it is also likely that jobs shedding is taking place. By industry, average hours worked is highest in mining and construction, and lowest in recreation & personal services and retail – possibly reflecting a greater reliance on casual and part-time workers in these industries.

Analysis (cont.)

Average hours still highest in mining, despite significant fall; Lowest hours in recreation & personal services and retail

Average weekly hours worked by industry (n.s.a.)



	Quarterly [(a)]					*Monthly*				
	2012q4	2013q1	2013q2	2013q4	2014q1	2012m11	2012m12	2013m1	2013m2	2013m03
Empl current	-3	**-2**				-5	-3	-6	-3	-5
Empl next 3m	3	-5	**1**							
Empl nxt 12m	16	9	6	-2	**3**					

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

Sales still the most significant constraint on output

Constraints on current output (% of firms)

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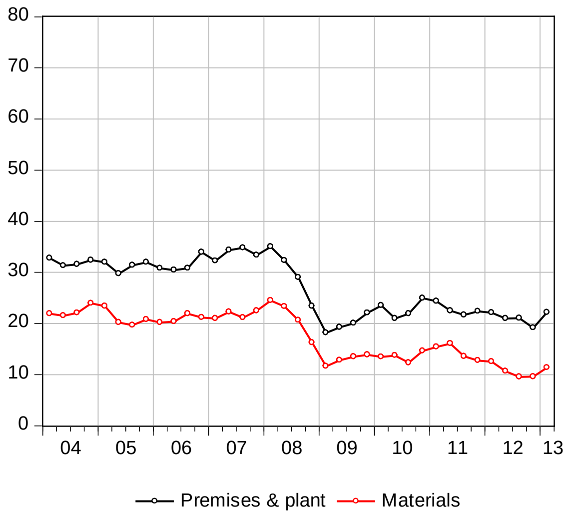


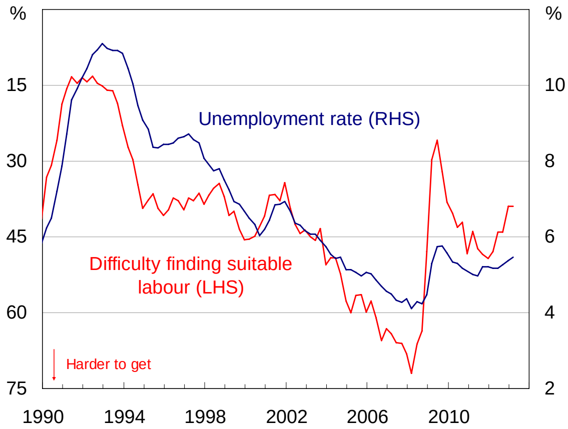
Sales remained the most constraining factor on output in the March quarter, with around 60% of firms reporting lack of sales and orders as their number one constraint. This outcome is consistent with the reported weakness in trading conditions and forward orders in the quarter. Concern about labour being a constraint on output was unchanged in the quarter and remains softer than it was a year ago, probably reflecting the increased slack in the labour market, making labour more easily accessible. While premises & plant and materials became slightly more constraining in the March quarter, they were only viewed as fairly minor constraints on output overall and remain significantly less constraining than they were in the lead up to the GFC, when utilised capacity was relatively tight.

Analysis (cont.)

The Survey measure of labour as a constraint on output (reversed) has historically moved quite closely with the unemployment rate. Just prior to the GFC in late 2008, over 70 per cent of firms reported that labour was a significant factor constraining output. The unemployment rate rose rapidly following the GFC, and consistent with this, firms were reporting significantly less difficulty finding access to suitable labour (less than 30 per cent of firms reported it as a constraint on output at the end of 2009). After the unemployment rate peaked in late 2009, it became increasingly difficult for firms to obtain suitable labour in the face of improving labour market conditions and the recommencement of hiring. Nonetheless, it is now much easier for firms to obtain suitable labour than it was prior to the GFC – consistent with the rising rate of unemployment – suggesting there is some slack in the labour market.

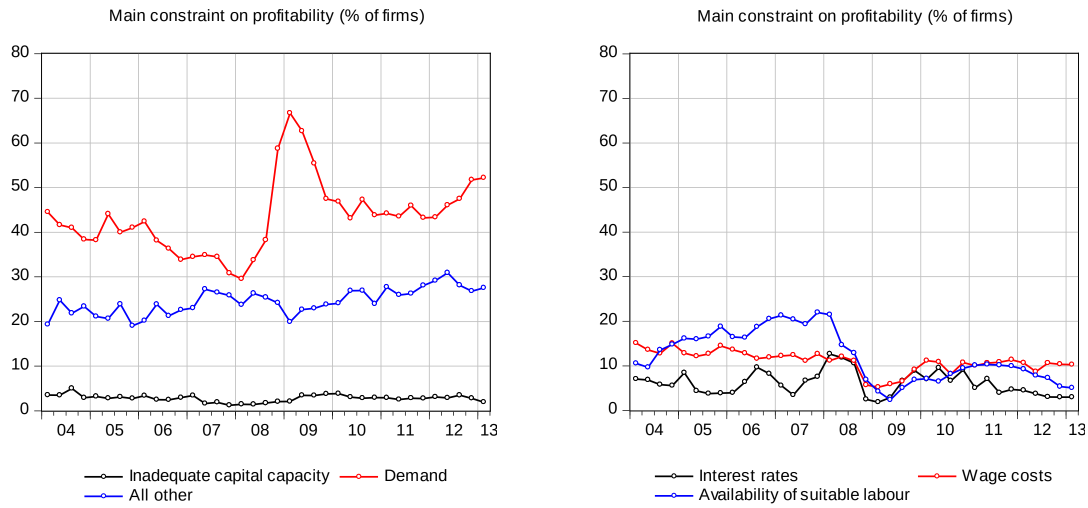
Labour relatively easy to find; points to rise in unemployment

Unemployment rate & labour constraints



Sources: ABS; NAB

Demand expected to constrain profitability over 2013



Lack of demand is expected to be the most constraining factor on firms' profitability over 2013, with more than half of respondents reporting demand as a major constraint on future profitability. Firms also reported 'all other' factors as relatively constraining in the March quarter; around half of this category represented concern about the impact of tax & government policy on future profitability, with the proportion of firms reporting this as a major constraint in the March quarter larger than in the previous quarter. Consistent with historically low borrowing rates as well as the relatively low rate of capacity utilisation in the economy at present, respondents view interest rates, inadequate capital capacity and the availability of suitable labour as relatively minor constraints on future profitability. The proportion of firms reporting wage costs as constraining factors was broadly unchanged, at close to 10%.

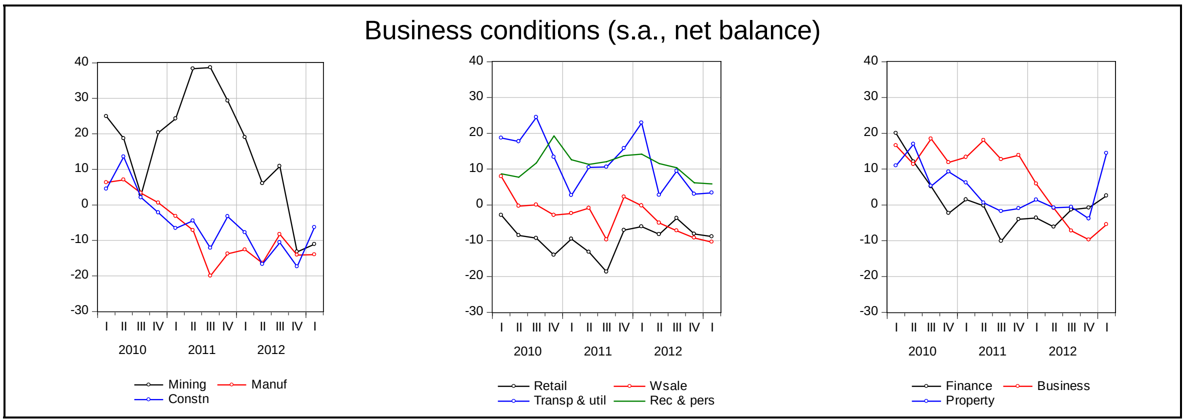
Constraints on output (% of firms)*	2012q1	2012q4	2013q1
Sales & orders	57.9	60.3	**60.0**
Labour	44.1	39.0	**38.9**
Premises & plant	21.1	19.1	**22.2**
Materials	9.6	9.6	**11.4**

Main constraints on profitability (% of firms)*	2012q1	2012q4	2013q1
Interest rates	3.0	3.0	**3.0**
Wage costs	10.6	10.4	**10.3**
Labour	7.3	5.3	**5.0**
Capital	3.5	2.8	**1.9**
Demand	47.4	51.7	**52.2**
All other	28.1	26.8	**27.5**

* *not s.a.*

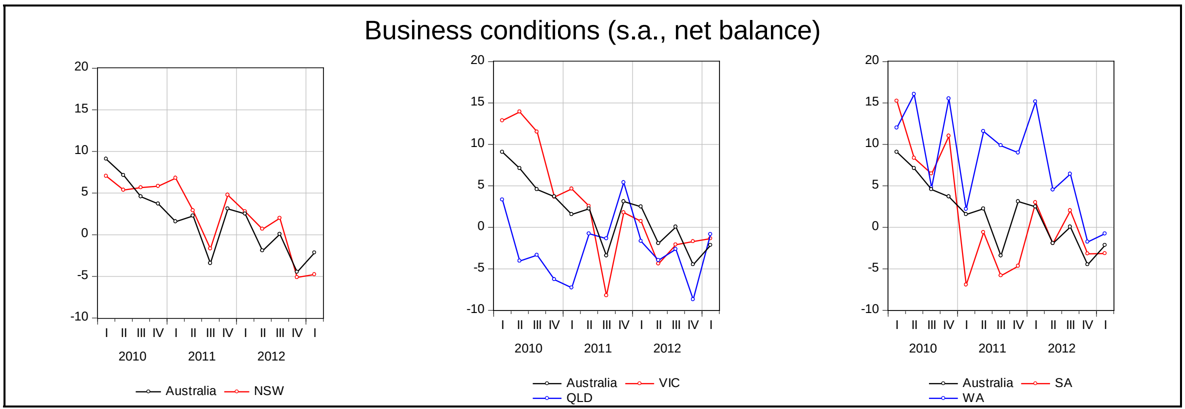
Industry and state analysis

Business conditions: manufacturing, wholesale, retail & mining very weak



Business conditions were little changed across most industries in the March quarter, with the exception of construction and finance/ business/ property, where they improved significantly (up 11 and 10 points respectively). While conditions in construction remain difficult (-6 points), they are much better than very weak levels reported at the end of 2012 suggesting lower borrowing rates may be helping to strengthen residential construction activity. It is also likely that the run up in equity prices since mid-November is helping to strengthen activity in finance/ business/ property. Retail and wholesale were the only firms to report (marginally) weaker conditions in the quarter, with this outcome suggesting the full impacts of lower borrowing rates are yet to fully work through the economy. In levels terms, conditions remained very poor in the consumer and trade dependent sectors – manufacturing, wholesale, retail and mining – suggesting the high AUD, lower commodity prices and the still cautious consumer continue to weigh on activity there.

Business conditions: Little difference in activity across states

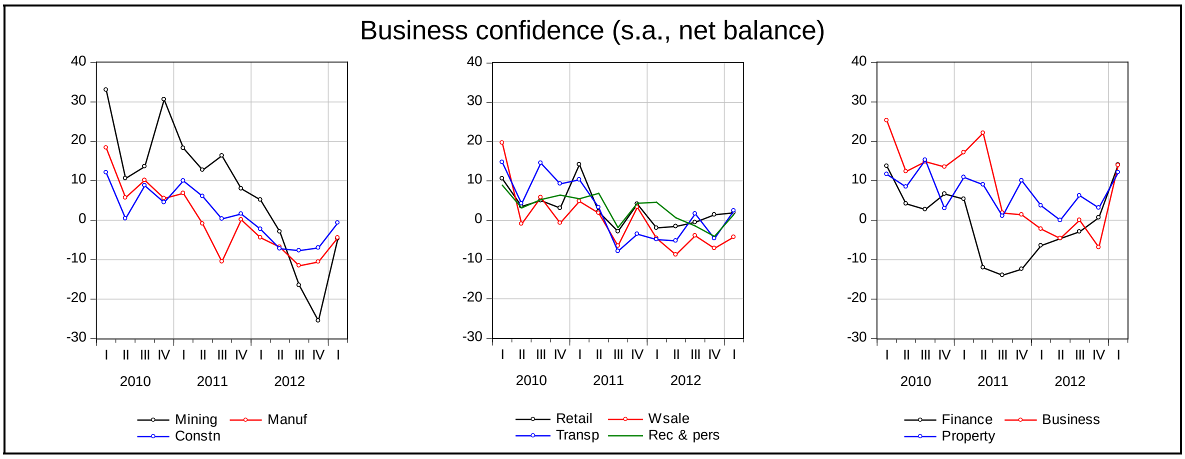


Business conditions were little changed across mainland states in the March quarter, with the exception of Queensland, where they lifted by a solid 8 points to -1 index point. Part of the rise in Queensland conditions may reflect the passing of bad weather as well as improved demand from major trading partners, especially Asia. Conditions improved marginally in Victoria and WA and were unchanged in the other mainland states. It appears that the slowing pace of mining investment growth has caused a notable deterioration in WA conditions over the past year, with conditions in this state now closely aligned with the other states. Conditions improved modestly in Tasmania (up 3) where they were a little better than the national average. Conditions are fairly similar across states, ranging from -5 in NSW, to -1 in Victoria, Queensland, WA and Tasmania.

	Quarterly					*Monthly*				
	2012q1	2012q2	2012q3	2012q4	2013q1	2012m11	2012m12	2013m1	2013m2	2013m03
Business conditions										
NSW	3	1	2	-5	**-5**	-4	-2	-5	-6	-4
VIC	1	-4	-2	-2	**-1**	-4	-5	-1	-1	-7
QLD	-2	-4	-3	-9	**-1**	-13	0	-6	-5	-2
SA	3	-2	2	-3	**-3**	-6	-16	-3	-4	-1
WA	15	5	6	-2	**-1**	-1	-11	0	2	-13

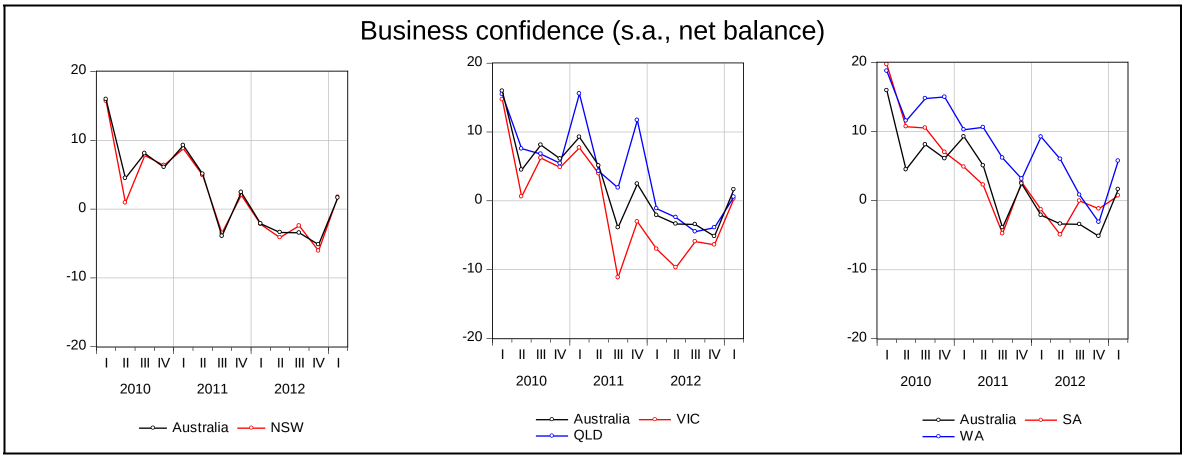
Industry and state analysis (cont.)

Confidence: finance, business & property services most optimistic



Business confidence improved across all industries in the March quarter, with mining and finance/ business/ property reporting particularly large rises. While mining confidence strengthened markedly in the month, it remains well below the levels reported prior to early 2012, probably reflecting lower commodity prices. The rise in finance/ business/ property confidence is likely to reflect recent strength in equities as well as an improved outlook for property prices on the back expectations for interest rates to remain relatively low for some time; this industry was by far the most upbeat in the quarter (at +14 points). Confidence levels were relatively subdued across the remaining industries, ranging from -5 points for mining, to +2 points for retail and transport & utilities.

Business confidence: confidence lifts in all states

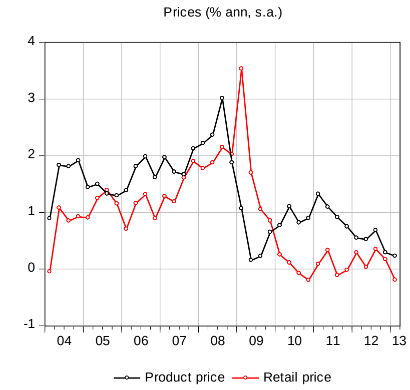


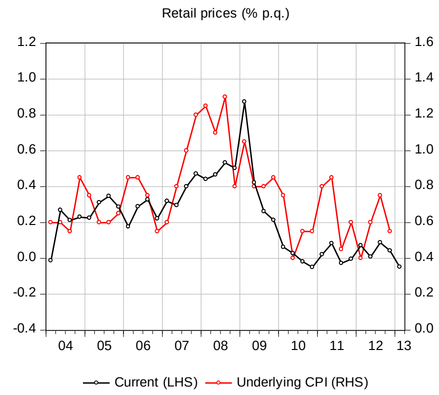
All of the states reported a strengthening in business confidence in the March quarter, with particularly solid increases reported in WA, NSW and Victoria. Confidence also rose notably in Tasmania and Queensland. Confidence readings were broadly similar across all states; business in WA were the most confident (+6), while readings in the other states ranged from zero points in Victoria to +2 points in NSW and Tasmania.

	Quarterly					*Monthly*				
	2012q1	2012q2	2012q3	2012q4	2013q1	2012m11	2012m12	2013m1	2013m2	2013m03
Business confidence										
NSW	-2	-4	-2	-6	**2**	-8	3	3	1	-1
VIC	-7	-10	-6	-6	**0**	-9	-1	2	2	0
QLD	-1	-2	-4	-4	**1**	-3	7	1	-1	1
SA	-1	-5	0	-1	**1**	-7	0	3	1	3
WA	9	6	1	-3	**6**	-12	12	9	0	4

Inflation and costs

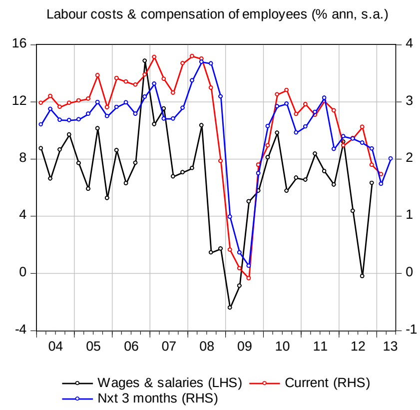
Price pressures still subdued: retail prices point to soft Q1 core inflation

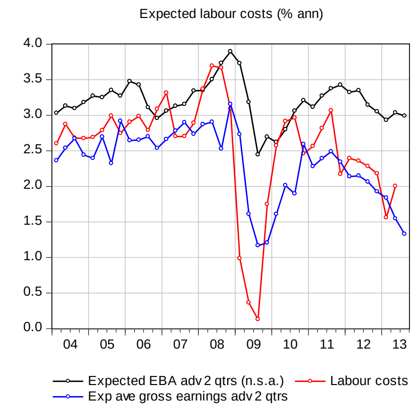




Consistent with the soft activity environment, product price inflation remained very subdued in the March quarter, at 0.1% (at a quarterly rate). While in aggregate price growth was unchanged, there were slight variations across some industries. Price growth appears to have softened marginally in many of the interest rate sensitive sectors – manufacturing, recreation & personal services, construction and transport & utilities – while price growth was a touch stronger in mining, wholesale and finance/ business/ property. Deflation was most apparent in mining (-0.4%), which is consistent with declines in commodity prices in the March quarter. Retail price growth was flat for a second consecutive quarter; the trend in the NAB retail price series is broadly consistent with official underlying inflation data, and points to a softening in underlying CPI in the March quarter.

Labour costs pressures fall back considerably





Quarterly annualised **labour costs** growth softened a touch to 1.7% in the March quarter, down from 1.9% in the December quarter. Labour costs are influenced primarily by changes in employment and wages: employment conditions remained in negative territory in the quarter so it is difficult to imply from this outcome what happened to wage pressures. However, it is likely that wages growth remains well contained at present, given the general softness in employment conditions. Wage increases under EBAs are expected to average 3.0% over the next year – unchanged from the previous quarter – or 1.8% after allowing for productivity offsets.

On average, businesses expect short-term interest rates to fall by a further 7 bps (down from 22 bps in the December quarter). The official interest rate reduction occurred at the RBA's December Board meeting, so the general easing in expectations for further interest rate reductions suggests that businesses view the Australian economy more favourably than they did at the time of the December quarter survey. Exchange rate expectations (6-months-ahead) were unchanged at $1.07 in the March quarter.

Medium-term inflation expectations remained reasonably relaxed, with 52% of respondents expecting inflation to remain below 3% (up from 48% in the previous quarter) and 41% expecting inflation of 3-4% (was 44%). Only 3% of respondents believe inflation is a serious problem (unchanged from previous quarter), while 29% believe it is a minor problem (30% in previously).

House prices are expected to rise by 1.7% over the next 12 months, up from 0.3% in the previous survey.

Macroeconomic, Industry & Markets Research

Australia		
Alan Oster	Group Chief Economist	+(61 3) 8634 2927
Jacqui Brand	Personal Assistant	+(61 3) 8634 2181
Rob Brooker	Head of Australian Economics & Commodities	+(61 3) 8634 1663
Alexandra Knight	Economist – Australia	+(61 3) 9208 8035
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Gerard Burg	Economist – Industry Analysis	+(61 3) 8634 2788
Robert De Iure	Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
John Sharma	Economist – Sovereign Risk	+(61 3) 8634 4514
Tony Kelly	Economist – International	+(61 3) 9208 5049
James Glenn	Economist – Asia	+(61 3) 9208 8129
Global Markets Research - Wholesale Banking		
Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Robert Henderson	Chief Economist Markets - Australia	+(61 2) 9237 1836
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045
New Zealand		
Tony Alexander	Chief Economist – BNZ	+(64 4)474 6744
Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Markets Economist, NZ	+(64 4) 474 6923
London		
Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+(44 20) 7710 2993
Tom Vosa	Head of Market Economics – UK/Europe	+(44 20) 7710 1573
Gavin Friend	Markets Strategist – UK/Europe	+(44 20) 7710 2155

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+(61 2) 9295 1166
Melbourne	+800 842 3301	+(61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+(44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+(65) 338 0019	+(65) 338 1789

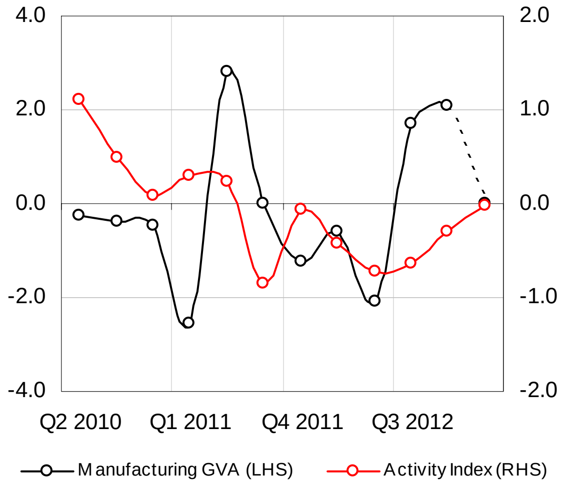
National Australia Bank

NAB Manufacturing Activity Index – Q1 2013

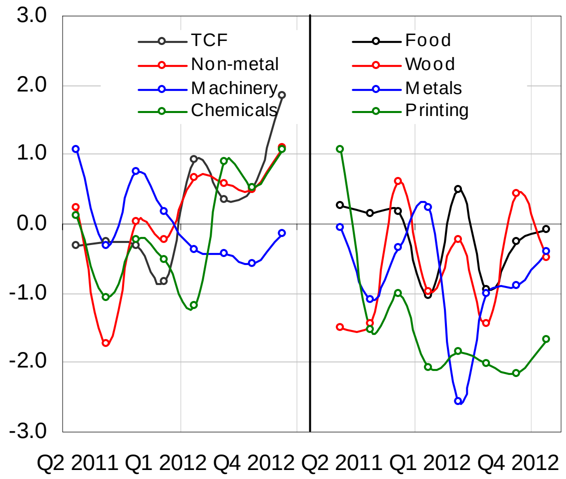
The Manufacturing Activity Index improved in Q1, up to neutral levels – driven largely by less negative levels for business confidence. The index implies no growth in quarterly manufacturing activity – which would represent a slowdown according to recent official data.

- NAB's Manufacturing Activity Index edged higher in the March quarter – back up to neutral levels, from -0.3 points in Q4 2012. This index level implies that there was no growth in quarterly manufacturing activity in Q1.
- The previous two quarters have seen a large divergence between our index and official data from the ABS. As highlighted in our Q4 release, the ABS series is subject to revision – with the reported increases over this period seemingly at odds with both the results of NAB's Business Surveys and anecdotal evidence from the sector.
- Business Confidence in the Manufacturing sector remained negative in Q1 2013 – but less negative than the past few quarters, at -4 points (from -10 points previously). This less negative trend was the key driver behind the Manufacturing Activity Index moving up to neutral levels. Large increases in confidence were recorded in Chemicals, the Textiles, Clothing & Footwear (TCF) sector and Machinery & Equipment.
- Final product prices recorded marginally softer trends for this index, tempering positive trends from business confidence, with growth down from +0.2% to +0.1%. Printing and Chemicals recorded the largest improvements in final price trends (albeit Printing prices still declined quarter-on-quarter). Wood products and TCF saw declining growth.
- Purchase costs increased at a marginally slower rate, down to +0.3% (below the trends recorded for the broader economy). By subsector, the changes were relatively modest, with declining trends in Metal products and TCF and an increase in Chemicals.
- Labour cost trends were also marginally softer at +0.6% – after a significant increase in the last quarter. The sectors that recorded the largest slowdown in labour cost growth were Non-metallic mineral products, TCF and Machinery & Equipment. In contrast, there were negative labour cost trends for Chemicals and Printing & Publishing.
- The upward trend for the Manufacturing Activity Index was exhibited across the subsectors of manufacturing – with the exception of Wood products, which saw a decline in the quarter.

Activity Index to neutral levels, indicates no growth for Mfg in Q1



Wood products softer; all other sectors improved



Activity Index	Q3 2012	Q4 2012	Q1 2013
Manufacturing	-0.6	-0.3	0.0
Food, Beverage, Tobacco	-1.0	-0.3	-0.1
Machinery and Equipment	-0.4	-0.6	-0.1
Metal Products	-1.0	-0.9	-0.4
Non-metallic Minerals	0.6	0.5	1.1

Activity Index	Q3 2012	Q4 2012	Q1 2013
Chemicals	0.9	0.5	1.1
Printing and Publishing	-2.0	-2.2	-1.7
Textile, Clothing, Footwear	0.3	0.5	1.8
Wood & Paper	-1.5	0.4	-0.5

For more information contact:
Alan Oster, Chief Economist
(03) 8634 2927 0414 444 652

All data is seasonally adjusted. Gross value added (GVA), Purchase costs, Labour costs and Final prices data are percentage changes expressed at a quarterly rate. Business confidence is a net balance index.

Manufacturing Activity Index: Index edges up to neutral levels, indicative of no growth for the Manufacturing sector

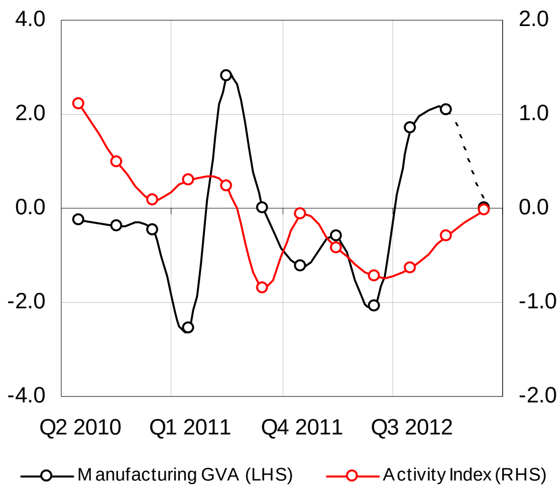
NAB's Manufacturing Activity Index edged higher in the March quarter – back up to neutral levels, from -0.3 points in Q4 2012.

This index level implies that there was no growth in quarterly manufacturing activity in Q1.

The index has been constructed to replicate movements in manufacturing activity. It comprises weighted components of business confidence and profits from NAB's Quarterly Business Survey (with the latter based on weighted movements in output and input prices, which are lagged by two quarters).

The previous two quarters have seen a large divergence between our index and official data on Manufacturing Gross Value Added (GVA) from the ABS. In the September and December quarters, our index implied declines in quarterly manufacturing activity, at around -1.3% and -0.6% respectively. In contrast, ABS data indicated increases of 1.7% and 2.1%.

The reported increases in manufacturing activity over the second half of 2012 are seemingly at odds with the results of NAB's Business Surveys and anecdotal evidence from the sector. As highlighted in our Q4 release, the ABS series is subject to significant revision – including cases of reported growth subsequently being revised to declines in later releases.

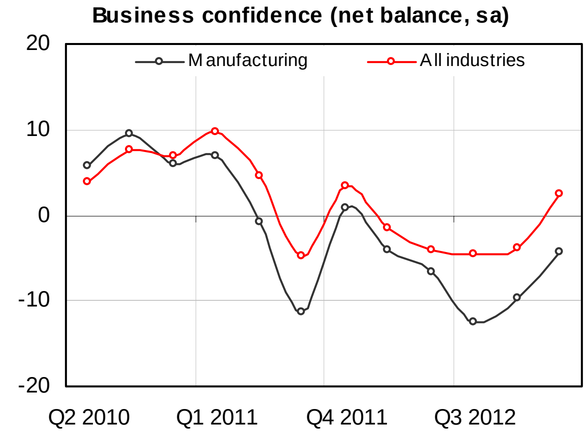


Activity Index Components: Less negative confidence was the key driver of improved Activity Index; softer product prices offset positive cost trends

Business Confidence in the Manufacturing sector remained negative in Q1 2013 – but less negative than the past few quarters, at -4 points (from -10 points in the December quarter). This less negative trend was the key driver behind the Manufacturing Activity Index moving up to neutral levels.

Manufacturers continue to face a challenging economic and competitive environment. The Australian dollar has remained persistently high, while global fears remain focused on Eurozone stability.

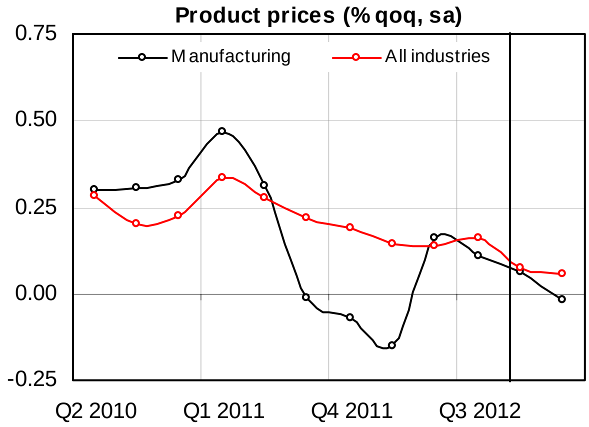
By subsector, large increases in confidence were recorded in Chemicals, the Textiles, Clothing & Footwear (TCF) sector and Machinery & Equipment.



Final product prices, one of the three lagged measures in our index, recorded marginally softer trends in Q3 2012, with growth down from +0.2% to +0.1%.

This level was slightly lower than the economy average in the quarter. That said, compared with the underperformance of manufacturing prices across late 2011-early 2012, these trends represent an improvement.

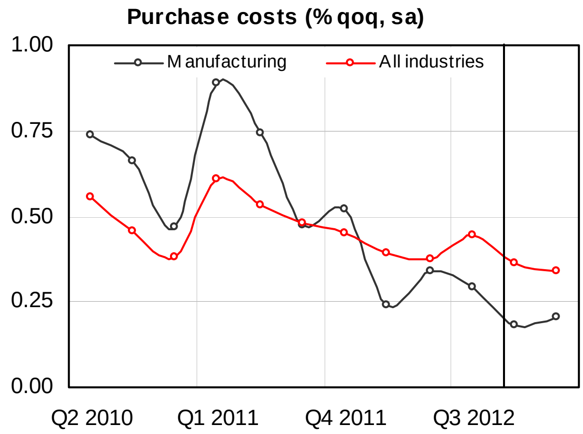
At a subsector level, Printing and Chemicals recorded the largest improvements in final prices (albeit Printing prices still declined quarter-on-quarter). Wood products and TCF saw declining growth.



Purchase costs increased at a slightly slower rate in Q3 2012, down to +0.3%. This level was below the trends recorded for the broader economy (where there was a slight uptick in costs).

The recent trends in purchase costs have been encouraging for the manufacturing sector, with growth rates lower again in both Q4 2012 and Q1 2013, a positive trend for the Activity Index in coming quarters.

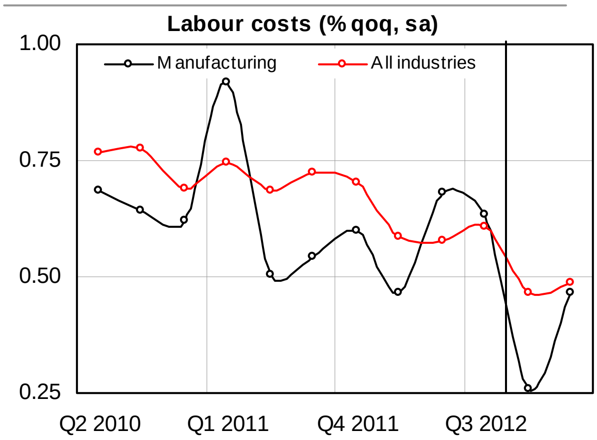
By subsector, the changes were relatively modest, with declining trends in Metal products and TCF and an increase in Chemicals.



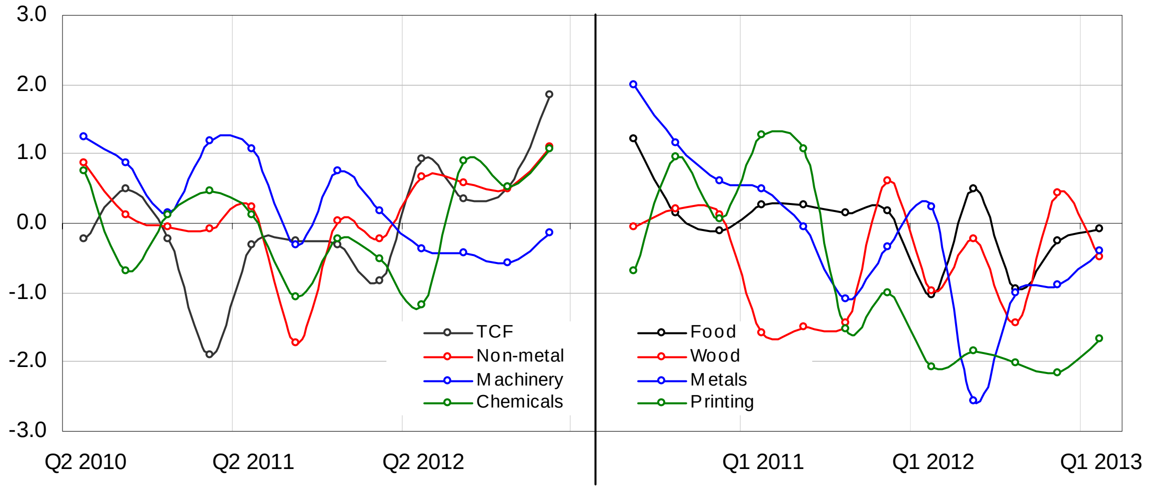
Labour cost trends were marginally softer in Q3 2012 at +0.6% – after a significant increase in the previous quarter pushed the measure to +0.7%.

The growth rate contracted sharply in the December quarter (down to +0.3%) – which will provide a significant boost to the Activity Index next quarter.

The sectors that recorded the largest slowdown in labour cost growth were Non-metallic mineral products, TCF and Machinery & Equipment. In contrast, there were negative labour cost trends for Chemicals and Printing & Publishing.



Subsector Analysis: Wood products softer, but all other sectors improved to drive the Activity Index back to neutral levels



The upward trend for the Manufacturing Activity Index was exhibited across the subsectors of manufacturing – with the exception of Wood products, which recorded a decline in the quarter.

The **Food & Beverage** activity index was slightly improved in Q1 – up to -0.1 points (from -0.3 points previously). Compared with other sectors, movements in the components of our index were relatively muted. The key drivers of this improvement were slightly stronger final product prices and slightly softer growth in purchase costs. These factors were tempered by a modest weakening in business confidence.

The **Chemicals** activity index strengthened considerably in the March quarter, up to +1.1 points (from +0.5 points in Q4). The sector was boosted by a significant increase in business confidence, however this was partially offset by worsening purchase cost trends. Higher final prices were largely cancelled out by rising labour costs.

The **Printing and Publishing** activity index recovered a little in Q1, but remained firmly negative at -1.7 points (up from -2.2 points in December). This recovery was largely the result of an improvement in final product prices along with a minor improvement in confidence, while trends for labour costs and purchase costs were both negative.

The **Textiles, Clothing & Footwear** activity index recorded the strongest improvement in the March quarter, up to +1.8 points (the strongest level in the quarter), from +0.5 points previously. The key drivers of this trend were a large increase in business confidence and an easing in purchase cost growth. Positive trends in labour costs were offset by negative moves in final product prices.

The **Wood Product** activity index was the only subsector to record a decline in Q1, down to -0.5 points (from +0.4 points previously). This sector has been one of the most volatile in our index – having recorded the largest improvement in Q4 2012. Trends for both final product prices and purchase costs were negative, driving the decline, while the positive effects of softer labour cost trends were offset by weaker business confidence.

The **Machinery & Equipment** activity index improved in the March quarter, up to -0.1 points (from -0.6 points in Q4). The main driver of the upturn was a recovery in business confidence, while trends for purchase costs were more negative. Changes to both labour costs and final product prices were relatively muted.

The **Metal Product** activity index was a little less negative in Q1, at -0.4 points (from -0.9 points in the December quarter). This result was driven by positive trends for purchase costs, with all other factors having only a modest impact in the quarter.

The **Non-metallic minerals** activity index moved higher in the March quarter, up to +1.1 points (from +0.5 points previously). Trends for both labour costs and purchase costs were positive, driving the index higher, while declines in business confidence were offset by stronger final product prices.

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8634 2927
Jacqui Brand	Personal Assistant	+(61 3) 8634 2181
Rob Brooker	Head of Australian Economics & Commodities	+(61 3) 8634 1663
Alexandra Knight	Economist – Australia	+(61 3) 9208 8035
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Gerard Burg	Economist – Industry Analysis	+(61 3) 8634 2788
Robert De Iure	Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
John Sharma	Economist – Country Risk	+(61 3) 8634 4514
Tony Kelly	Economist – International	+(61 3) 9208 5049
James Glenn	Economist – International	+(61 3) 9208 8129

Global Markets Research - Wholesale Banking

Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Robert Henderson	Chief Economist Markets - Australia	+(61 2) 9237 1836
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045

New Zealand

Tony Alexander	Chief Economist – BNZ	+(64 4) 474 6744
Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Markets Economist, NZ	+(64 4) 474 6923

London

Tom Vosa	Head of Market Economics - Europe	+(44 20) 7710 1573
David Tinsley	Market Economist – Europe	+(44 20) 7710 2910

	Foreign Exchange	**Fixed Interest/Derivatives**
Sydney	+800 9295 1100	+(61 2) 9295 1166
Melbourne	+800 842 3301	+(61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+(44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+(65) 338 0019	+(65) 338 1789

National Australia Bank

Embargoed until:
11.30am Thursday 18 April 2013

Subscriber details

March quarter 2013

Business confidence lifts from late 2012 lows but still below average. That reflects better global confidence, stronger equity prices and lower borrowing rates at home. Conditions still subdued and with marked weakness in trade and consumer dependent sectors. Forward indicators and medium-term expectations still very poor. Capex expectations imply flat investment (falling in non-mining). Low price pressures imply soft Q1 core inflation.

- Business confidence improved significantly in the March quarter – the first quarterly rise in sentiment since December 2011. That said confidence still remains below long-run average levels. Much of the improvement in confidence reflects the unwinding of concern surrounding a number of external risks, including the US fiscal cliff, a hard landing in China and the reduced risk of a further European crisis. While equity price rises and lower borrowing rates are also likely to have helped, it appears the still high AUD remains concerning for the trade dependent industries.
- Business conditions strengthened modestly in the March quarter, after weakening to their lowest level since June quarter 2009 in the previous survey. That said, business conditions are still clearly signaling below trend growth. Indeed, the NAB quarterly business survey points to domestic demand growth in March quarter 2013 of around 2¼%. More worrying forward indicators of demand remain subdued – notably forward orders, stocks and capital expenditure – suggesting activity will soften into the June quarter. There are indeed signs of that happening in the March Monthly Business Survey.
- The improvement in business conditions is almost entirely attributable to two industries; finance/ business/ property, which probably gained from rising equity prices and easier financial conditions, while lower borrowing rates appear to have helped to strengthen construction activity. Consumer and trade dependent sector conditions remained weak, implying that either lower interest rates need more time, or more stimulus (eg. RBA rate cuts) are needed to strengthen consumer demand. Conditions were little changed across mainland states in Q1, with the exception of Queensland, where they lifted considerably.
- Business investment intentions (next 12 months) lifted a touch in Q1 but remained low relative to outcomes a year or two ago. Indeed, they imply flat investment growth over the next 12 months. This is consistent with NAB's expectation for non-mining investment to take time to fill the approaching 'gap' from a slowing in mining investment. Near and longer term employment expectations ticked up but point to more labour market weakness. Lack of demand is expected to be the most significant factor impacting profitability over the next 12 months and concerns about tax & government policy remain important.
- Product price inflation remained subdued, recording annualised growth of just 0.2%. Retail price inflation was also soft and implies a soft March quarter underlying inflation outcome. Labour and purchase costs growth remained modestly below-average levels.

Implications for NAB forecasts:

- No change to latest Global and Australian Forecasts (released 9 April).

Key quarterly business statistics**

	2012q3	2012q4	**2013q1**		2012q3	2012q4	**2013q1**
		Net balance				*Net balance*	
Business confidence	-3	-5	**2**	Trading	5	-3	**0**
Business conditions				Profitability	-1	-8	**-4**
Current	0	-5	**-2**	Employment	-2	-3	**-2**
Next 3 months	5	-1	**5**	Forward orders	-4	-8	**-7**
Next 12 months	17	11	**17**	Stocks	3	-1	**-3**
Capex plans (next 12)	14	10	**13**	Exports	-1	-2	**-1**
		% change				*% change*	
Labour costs	0.6	0.5	**0.4**	Retail prices	0.1	0.0	**0.0**
Purchase costs	0.5	0.3	**0.3**			*Per cent*	
Final products prices	0.2	0.1	**0.1**	Capacity utilisation rate	80.7	79.4	**80.3**

** All data seasonally adjusted, except purchase costs and exports. Fieldwork for this Survey was conducted from 25 February to 13 March 2013, covering over 900 firms across the non-farm business sector.

For more information contact:
Alan Oster, Chief Economist
(03) 8634 2927 0414 444 652

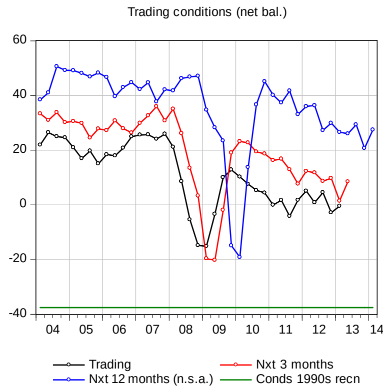
Next release:
13 May 2013 (April Monthly)

Subscriber details

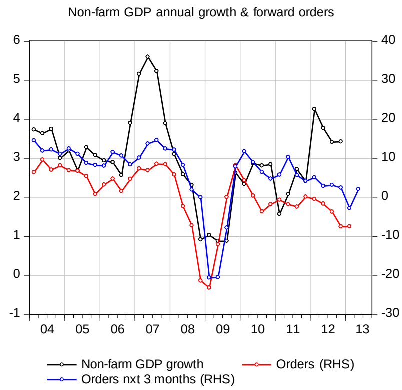
The **trading conditions** index improved modestly in the March quarter – up 3 to zero index points – only partly unwinding a sharp deterioration in the previous quarter. Despite the lift in trading activity, the series remains well below its long-run average of +6 points since 1989. The lift in trading activity was most apparent in mining and construction – up 14 and 12 points respectively – while solid improvements were also reported in wholesale and finance/ business/ property (both up 7). Trading conditions were strongest (and positive) in finance/ business/ property, while they were very poor in retail and manufacturing. Consistent with the improvement in actual conditions, near-term expected trading conditions (three-months-ahead) and longer term expectations (12-months-ahead) strengthened modestly. Near-term expected trading conditions rose markedly in finance/ business/ property, construction and mining, while transport & utilities was the only industry to report a (marginal) deterioration in expectations.

The **forward orders** index rose marginally to -7 index points in the March quarter, after falling to its lowest level since June quarter 2009 in the previous quarter. Despite the weakness in new orders, near-term expectations (3-months-ahead) strengthened (up 5 to +2 points), more than offsetting a modest deterioration in the previous quarter. When viewed in tandem with below-average employment conditions, capital expenditure and capacity utilisation, the overall weakness in forward indicators is consistent with NAB's expectation for GDP to remain below-trend over 2013, and for labour market conditions to soften further.

Trading expectations improve but still soft



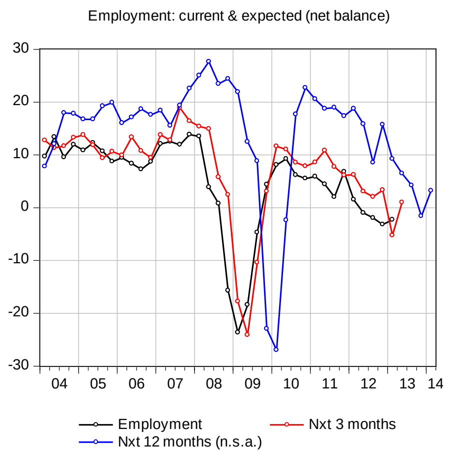
Orders outlook still subdued



By industry, forward orders improved solidly in mining and were a touch better in finance/ business/ property, while they deteriorated across all other industries (with falls ranging from 1 to 4 points in magnitude). Forward orders were particularly weak in wholesale, manufacturing and retail, while they were least subdued (albeit still negative) in finance/ business/ property.

Historically, orders in wholesale have tended to have a leading relationship with retail orders. As such, the particularly sharp deterioration in wholesale orders tends to suggest retailers may continue to experience weak orders in coming months. Within retail, orders deteriorated significantly in car retailing, while they improved in personal & household goods retailing.

Employment outlook a little better



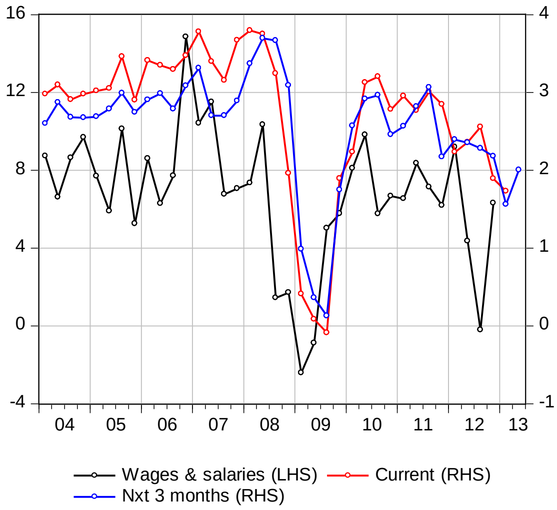
Employment conditions edged higher in the March quarter (up 1 point to -2 index points) – the first quarterly rise in one year. With the overall index still in negative territory, the NAB survey points to greater weakness in the labour market than that implied by official ABS labour force employment data, which showed a ½% rise in employment in the March quarter. However, the unemployment rate – perhaps a better measure of labour market conditions – rose from 5.4% in December to 5.6% in March, suggesting a general softening in labour market conditions through the quarter. Near and longer term expectations for employment conditions improved, although they remain low relative to recent history.

Subscriber details (cont.)

Labour costs growth eased to 1.7% (at a quarterly annualised rate) in the March quarter, down from 1.9% in the December quarter. Consistent with the expectation for employment conditions to remain soft, expectations for labour costs imply cost pressures will remain contained in the near term, albeit a little stronger than in the March quarter.

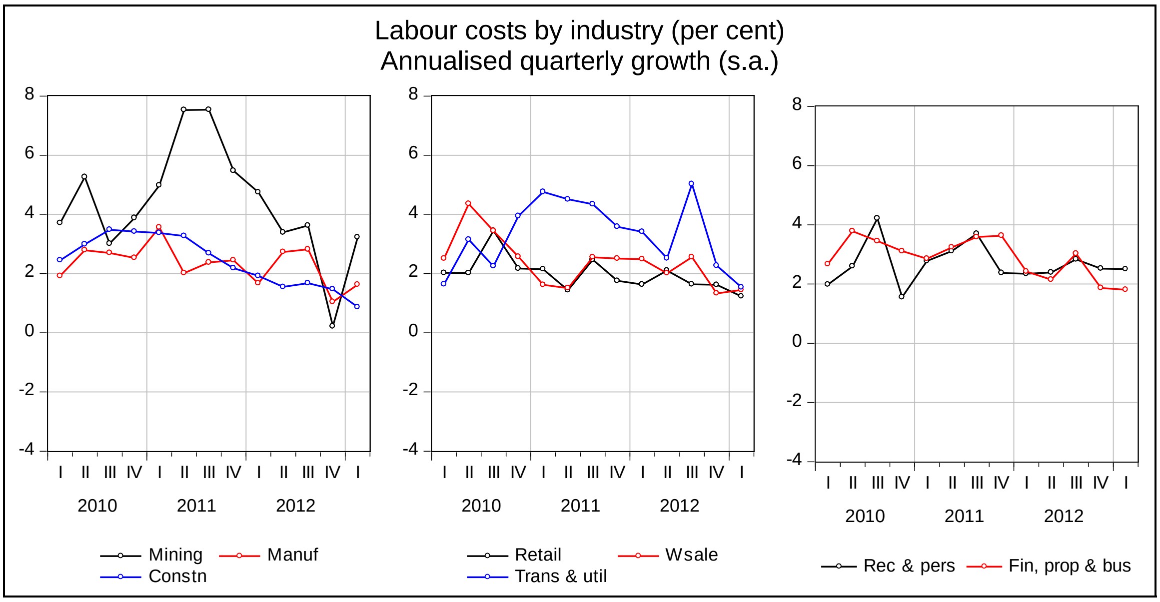
The rise in labour costs growth almost entirely reflected an increase in mining cost pressures, where labour costs growth was strongest – mining employment conditions were unchanged in the quarter, implying that wage pressures have increased since the end of 2012. Elsewhere, labour cost pressures softened a little in construction, transport & utilities, retail and finance/ business/ property. Labour costs growth was softest in construction and retail.

Labour cost pressures ease further, in line with still soft employment



The expected increase in annual average earnings under EBAs was unchanged at 3.0% in the March quarter. However, the anticipated productivity offset rose to 1.2%, from 0.9% in the December quarter, implying a slight softening in overall expected net EBA growth to 1.8%.

Labour costs growth strongest in mining; broadly similar elsewhere

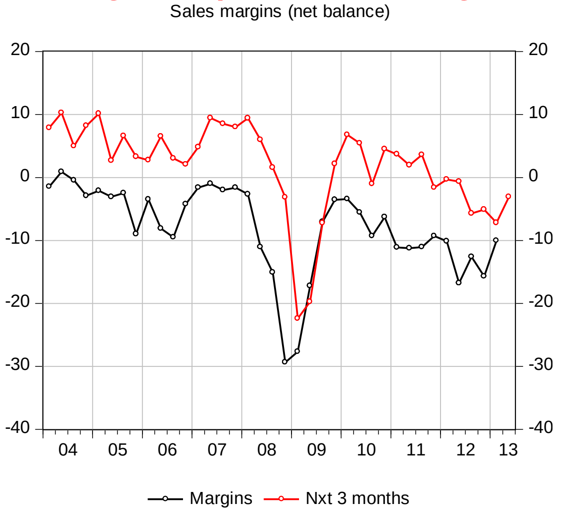


Expected net EBA growth highest in recreation & personal services and mining; lowest in finance/ business/ property and wholesale

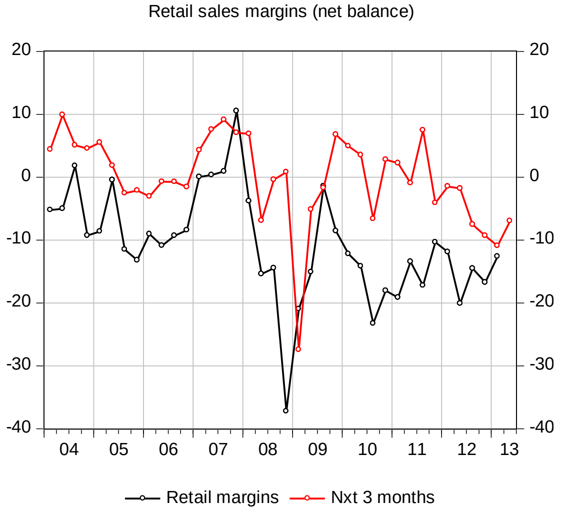
	Mining	Manuf	Const	Retail	Wsale	Trans	Rec. & pers.	Fin. prop. & bus.	Aust.
Expected EBA growth	2.9	2.8	3.3	2.9	2.7	2.7	3.2	2.8	3.0
Productivity offset	0.8	1.2	1.6	1.1	1.3	0.6	1.0	2.0	1.2
Net EBA growth	2.1	1.6	1.7	1.7	1.3	2.0	2.2	0.9	1.8

Subscriber details (cont.)

Margins improve but still tight

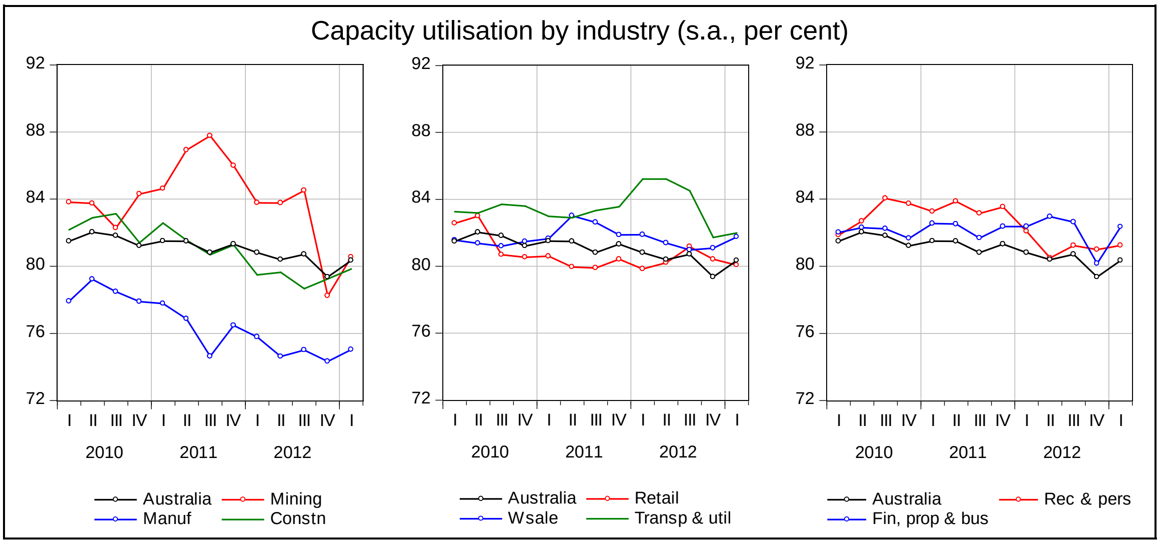


Retail margins remain tight



The **margins** index improved in the March quarter (up 6 to -10 points), after falling to its lowest level since June quarter 2009 at the end of last year. Three-month-ahead expectations also strengthened, although the index remained in negative territory and below-average levels, implying margins will remain tight in the June quarter. The expectation for margins to continue to deteriorate in the near term is consistent with expectations for purchase and labour costs growth to outpace growth in product prices. The margins index remained negative in all industries for a forth consecutive quarter, with particularly weak outcomes reported in manufacturing, mining, wholesale, retail and construction – consistent with weak business conditions in these industries. Retail margins improved modestly in the quarter, but with no growth in product prices combined with rising costs growth, overall margins remained difficult.

Capacity utilisation still very low in manufacturing; fairly similar across other industries

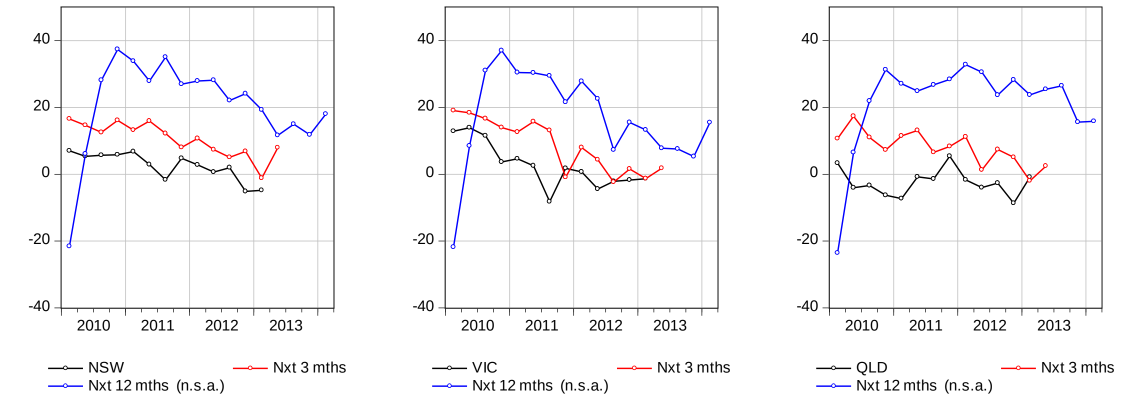


Capacity utilisation (seasonally adjusted) increased notably to 80.3% – up from 79.4% in the December quarter. The overall increase largely reflected significant rises in utilised capacity in mining – probably in response to some unwinding of bad weather effects towards the end of last year, and finance/ business/ property, which may have experienced better activity as a result of easier financial conditions and rising property prices. Capacity utilisation increased in all other industries, with the exception of retail, where it fell modestly. The level of utilised capacity was highest in finance/ business/ property, wholesale and recreation & personal services, while it was very low in manufacturing, followed by construction and retail.

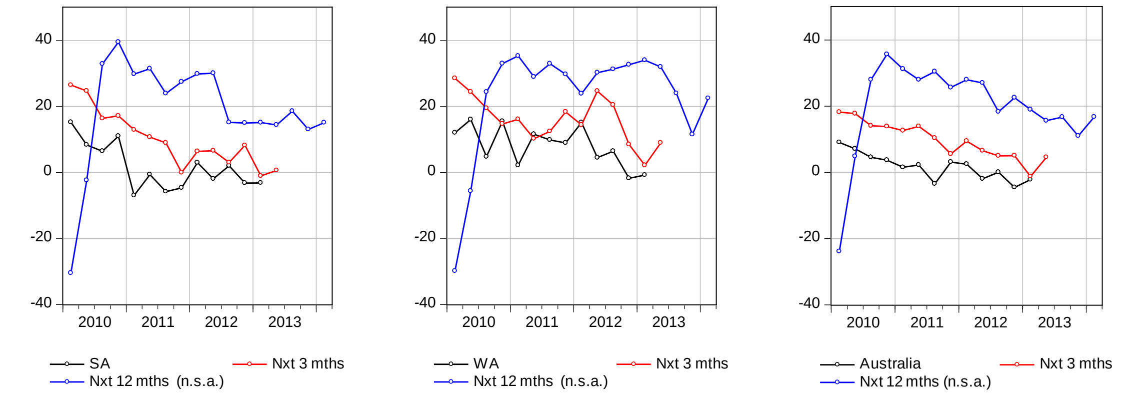
Subscriber details (cont.)

Long-term expected conditions shift up across all mainland states, but still poor relative to recent history

Business conditions by state: actual & expected (net balance)



Business conditions by state: actual & expected (net balance)



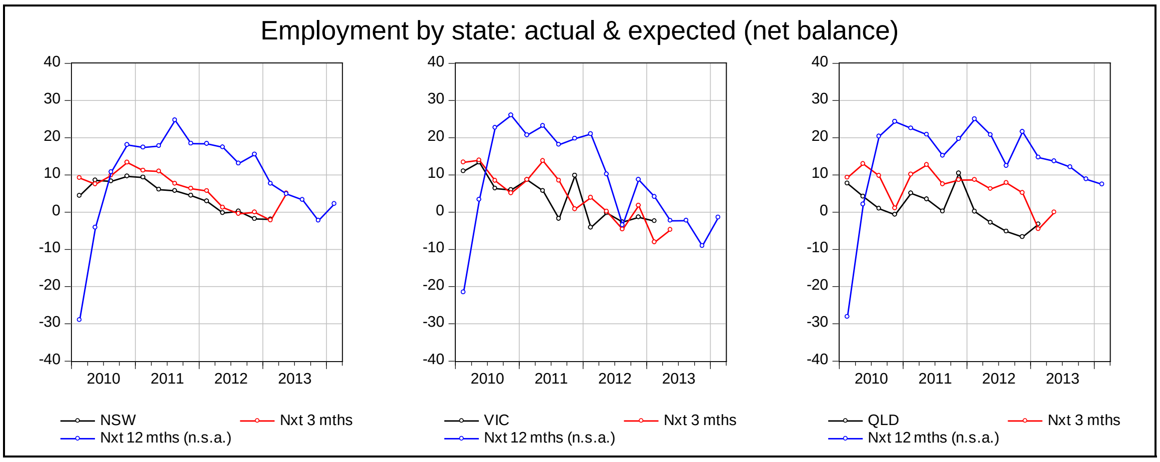
Business' expectations for near-term activity (next three months) improved in the March quarter, though the outlook for activity is still relatively poor. The upward shift in expectations was broadly-based across the mainland states, with particularly sharp increases reported in WA and NSW – where expectations were also the strongest. Expectations were broadly similar across the remaining mainland states, ranging from +2 to +4 points.

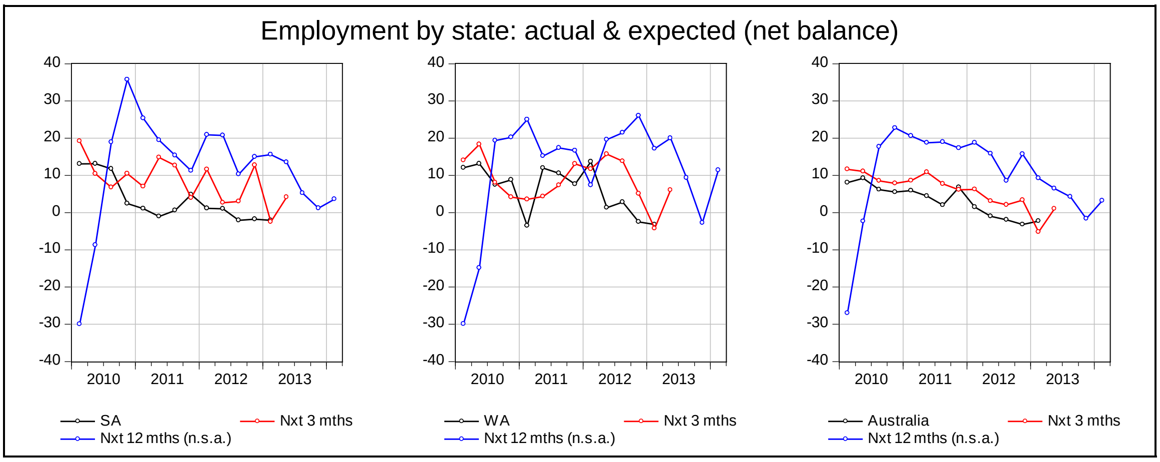
Longer term expected business conditions (next 12 months) also improved across all mainland states in the March quarter, with marked improvements reported in WA and Victoria. Nonetheless, the level of expectations is generally below the level reported over the past three or so years, implying an overall downgrade to longer term expectations. Overall, expectations were strongest in WA, while they were broadly similar across the other mainland states.

Business conditions in Tasmania improved modestly in the March quarter, to be a little better than the national average. While care should be taken when interpreting data for Tasmania due to small sample size, there is no denying the solid turnaround in activity in this state, with the conditions index having gradually strengthened from a low of -38 index points in September quarter 2011, to -1 index point in the March quarter. Near-term and longer term expectations were up solidly, although they remained at a relatively low level when compared to the mainland states.

Subscriber details (cont.)

Employment expectations improve across all states, except Queensland





Across the mainland states, employment conditions improved modestly in Queensland in the March quarter, while they weakened slightly in WA and Victoria and were unchanged everywhere else. In levels terms, conditions were very similar across states, ranging between -2 and -3 index points.

Near-term expectations (next three months) for employment conditions strengthened across all of the mainland states in the March quarter, with the strongest increases occurring in WA, SA and NSW. Despite the broad-based increase, the level of expectations was varied across states; employment conditions are expected to strengthen more significantly in WA, NSW and SA, while they are expected to deteriorate in Victoria, and to remain broadly unchanged in Queensland.

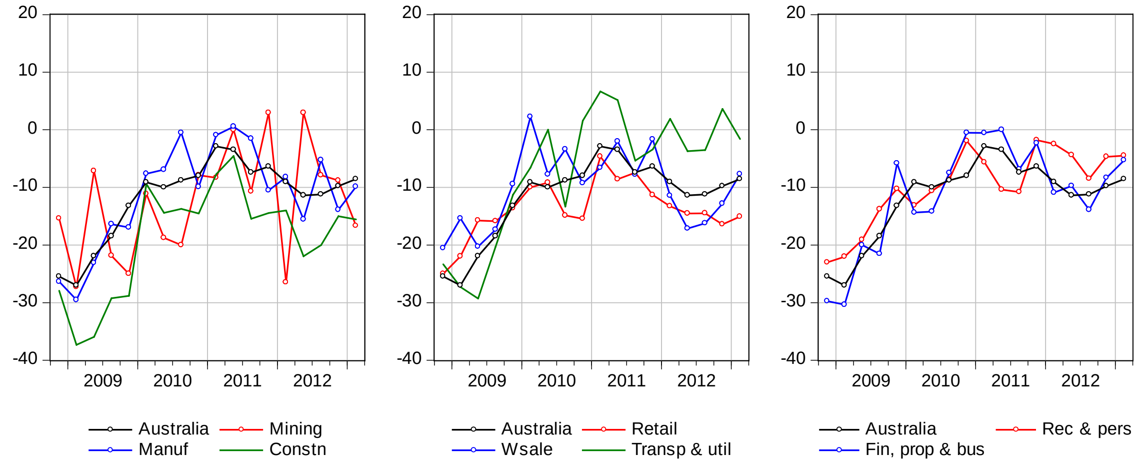
Longer term expectations of employment conditions (next 12 months) improved across all states, except in Queensland where they weakened marginally. Particularly solid improvements were reported in WA and Victoria, although expectations for the latter remained in negative territory. In levels terms, expectations varied across states, with WA and Queensland the most optimistic about the outlook for labour market conditions, while expectations are much softer for businesses in Victoria, NSW and SA. Nonetheless, overall expectations for employment conditions are low across all of the states compared to recent history, suggesting that employment growth may be subdued over the year ahead.

Employment conditions strengthened in Tasmania, although remained quite poor when compared to the other states. Near-term expectations were marginally better, albeit subdued, while longer term expectations deteriorated modestly to still poor levels. It may be the case that businesses in Tasmania are concerned about government downsizing, which is likely to have a particularly big impact on the Tasmanian economy relative to the other states.

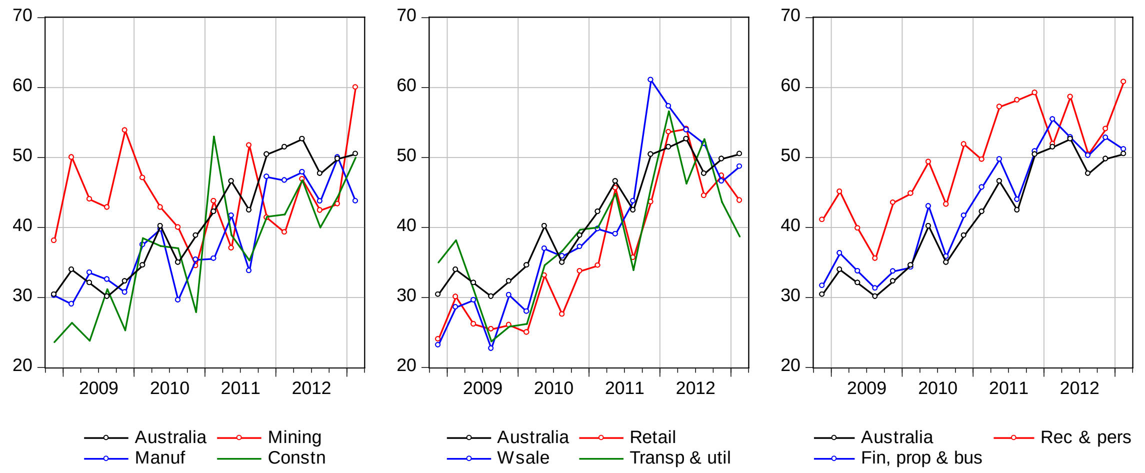
Subscriber details (cont.)

Finance hardest to obtain in mining; demand for borrowing highest in recreation services and mining, lowest in transport

Ease of borrowing index (n.s.a., net balance, easier less more difficult)



Respondents requiring no borrowing (n.s.a., per cent)



Borrowing conditions became marginally easier for firms in the March quarter compared to more difficult conditions experienced at the end of last year, although finance was still relatively difficult to obtain overall. Borrowing became easier for all industries except for mining, transport & utilities and construction. Overall, finance was least difficult to obtain in transport & utilities, recreation & personal services and finance/ business/ property – the three best performing industries in the March quarter. In contrast, borrowing conditions were most difficult in mining, construction and retail.

Half of all responding firms required borrowing in the March quarter, unchanged from the December quarter. Demand for borrowing increased strongly in mining and recreation & personal services, while it softened most notably in manufacturing, transport & utilities and retail. Consistent with a solid rise in the quarter, demand for borrowing was highest in recreation & personal services and mining, while transport & utilities, manufacturing and retail required the least amount of borrowing.

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8634 2927
Jacqui Brand	Personal Assistant	+(61 3) 8634 2181
Rob Brooker	Head of Australian Economics & Commodities	+(61 3) 8634 1663
Alexandra Knight	Economist – Australia	+(61 3) 9208 8035
Vyanne Lai	Economist – Agribusiness	+(61 3) 8634 0198
Dean Pearson	Head of Industry Analysis	+(61 3) 8634 2331
Gerard Burg	Economist – Industry Analysis	+(61 3) 8634 2788
Robert De Iure	Economist – Property	+(61 3) 8634 4611
Brien McDonald	Economist – Industry Analysis & Risk Metrics	+(61 3) 8634 3837
Tom Taylor	Head of International Economics	+(61 3) 8634 1883
John Sharma	Economist – Sovereign Risk	+(61 3) 8634 4514
Tony Kelly	Economist – International	+(61 3) 9208 5049
James Glenn	Economist – Asia	+(61 3) 9208 8129

Global Markets Research - Wholesale Banking

Peter Jolly	Global Head of Research	+(61 2) 9237 1406
Robert Henderson	Chief Economist Markets - Australia	+(61 2) 9237 1836
Spiros Papadopoulos	Senior Economist – Markets	+(61 3) 8641 0978
David de Garis	Senior Economist – Markets	+(61 3) 8641 3045

New Zealand

Tony Alexander	Chief Economist – BNZ	+(64 4)474 6744
Stephen Toplis	Head of Research, NZ	+(64 4) 474 6905
Craig Ebert	Senior Economist, NZ	+(64 4) 474 6799
Doug Steel	Markets Economist, NZ	+(64 4) 474 6923

London

Nick Parsons	Head of Research, UK/Europe & Global Head of FX Strategy	+(44 20) 7710 2993
Tom Vosa	Head of Market Economics – UK/Europe	+(44 20) 7710 1573
Gavin Friend	Markets Strategist – UK/Europe	+(44 20) 7710 2155

	Foreign Exchange	Fixed Interest/Derivatives
Sydney	+800 9295 1100	+(61 2) 9295 1166
Melbourne	+800 842 3301	+(61 3) 9277 3321
Wellington	+800 64 642 222	+800 64 644 464
London	+800 747 4615	+(44 20) 7796 4761
New York	+1 800 125 602	+1877 377 5480
Singapore	+(65) 338 0019	+(65) 338 1789