Australian Chamber–Westpac Survey of Industrial Trends

Australian Chamber of Commerce and Industry & Westpac Banking Corporation

219th report June 2016 (survey conducted 9 May to 6 June 2016)

- The Australian Chamber-Westpac Survey of Industrial Trends, Australia's longest running business survey, dating from 1966, provides a timely update on manufacturing and insights into economy-wide trends.
- The Westpac-AusChamber Actual Composite index moderated in the June quarter to 55.1, down 6.3pts. That is still a positive reading, coming on the back of a particularly strong 61.4 in March, to be more in line with the average for 2015 of 56.4.
- The above par reading for the Composite index, which trended higher in 2014 and 2015, reflects strength across new orders, output, overtime, and an emerging resilience in employment.
- Manufacturing is benefitting from a strong upswing in new home building activity, although rates of growth have moderated, as well as the lift in renovation activity and the significant improvement in competitiveness flowing from the sharply lower currency, down 20% against the US dollar since mid-2014. Even so, the cycle remains constrained. Mining investment is turning down sharply and global fragilities persist. Consumer spending has gained momentum recently, but remains far from strong.
- The modest uptrend in exports was broken in June, with a net 3% of firms reporting a decline. Expectations are for the uptrend to resume, supported by the lower AUD but constrained by still sluggish world growth.
- Expectations are positive, centred on new orders and output. Firms intend to respond to this strength by increasing overtime and broadly maintaining their existing workforce. The Expected Composite index is at 60.8, up 2.0pts on March. A net 18% expect the general business environment to strengthen over the next six months, an upbeat mood, up from a net 15% in March.
- Businesses are looking for 2016 to be a positive year for profits, driven by rising turnover and a lower Australian dollar boosting export returns. A net 19% expect profits to rise in the 12 months ahead.
- Investment intentions have strengthened, consistent with an extended trend reduction in the sector's spare capacity and improving profitability. A net 21% of firms expect to increase equipment spending in the next year. Investment plans for building investment are more muted, at a net +3%.
- The survey's Labour Market Composite moderated to a still positive 54.6 in June, down from a high of 56.9 in March. The Index, which correctly foreshadowed the strengthening in economy wide jobs growth evident over the past year, points to solid job gains during 2016.

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Net response or "balance" is calculated by the proportion of "ups" less "downs" on individual questions, thereby yielding the net balance. A positive balance indicates a net upward or improving trend and a minus balance a net downward or deteriorating trend.

The 219th consecutive survey was closed on 6 June 2016.
A total of 287 responses were received, and provided a reasonable cross-section of Australian manufacturing in respect of industry groups and size of operation.
The next survey will be conducted over August/September 2016.

Key survey results

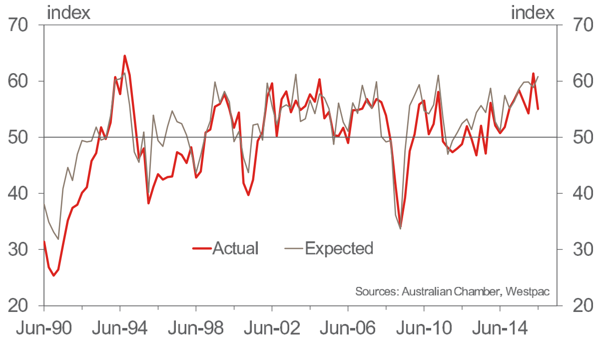
Westpac–AusChamber Composites, seasonally adj.

	Q1 2016	Q2 2016
Actual – composite index	61.4	55.1
Expected – composite index	58.8	60.8

- The Westpac-AusChamber Actual Composite index moderated in the June quarter, to 55.1, down from 61.4 in March, to be more in line with the 2015 average of 56.4. Strength remains evident across most components of the index, notably: new orders; output; and overtime; along with an emerging resilience in employment.
- Manufacturing is benefitting from the significant easing of monetary conditions. Home building is in the midst of a strong upswing in response to historically low interest rates. The sharply lower dollar is benefitting exporters and import competing firms, including food manufacturing.
- The Expected Composite index strengthened by 2pts in June to 60.8. Expectations are for stronger orders and output, as well as overtime.

Westpac-AusChamber Composite indexes

Actual & expected, sa

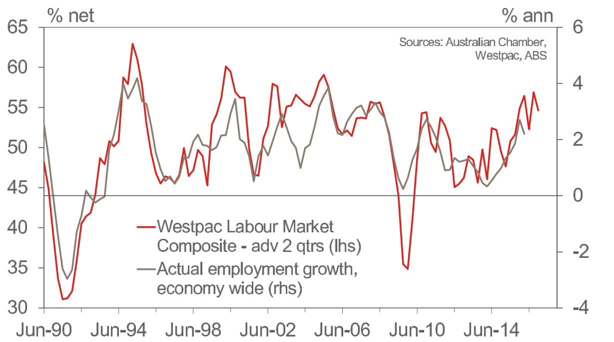


Westpac–AusChamber Labour Market Composite

	Q1 2016	Q2 2016
Net balance	56.9	54.6

- The Westpac-AusChamber Labour Market Composite index moderated in the June quarter, to 54.6, down from 56.9 in March. The index is still at a relatively positive level, coming off a strong reading in June.
- In this cycle, the Labour Market Composite has once again proven itself to be a reliable lead indicator of economy wide jobs growth. This highlights the key linkages between manufacturing and the household sector.
- Official data reports that employment across Australia grew by 2.2% in the year to the March quarter, accelerating from 1.3% over the year to March 2015, as foreshadowed by the Labour Market Composite.
- The survey points to solid jobs growth in 2016.

Employment momentum extends into 2016



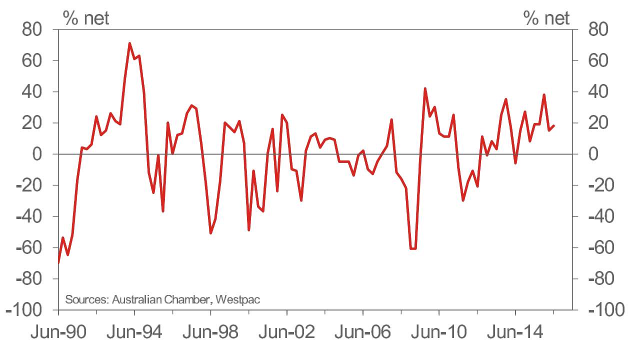
General business situation

	Q1 2016	Q2 2016
Net balance	15	18

- The manufacturing sector is thinking positively in 2016. In the June quarter, a net 18% of respondents expect the general business environment to strengthen over the next six months. That is broadly in line with March, +15%, and the 2015 average, +21%.
- As well as the strong home building upswing, a major plus is the sharply lower currency, at around US75¢ over recent months. That is down 20% from mid-2014 and 40% below levels seen in early 2013.
- Consistent with this positive mood around the general business environment, the Westpac-AusChamber Expectations Composite is elevated, at 60.8, in line with readings from mid-2015.

General business situation

Next six months



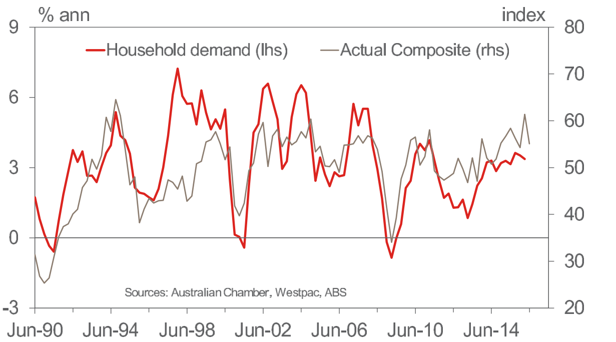
The business cycle & economic outlook

Manufacturing & the business cycle

- The Westpac-AusChamber Actual Composite index has a solid track record of predicting near-term domestic economic conditions, including identifying turning points in the cycle.
- In particular, the Composite tracks movements in household demand, highlighting the key linkages between the consumer, home building and manufacturing.
- The national accounts confirm that household demand, that is consumer spending and home building activity, has strengthened in response to low interest rates. Annual growth was a little above trend in early 2016, at 3.4%, having accelerated from a sub-par pace in 2013.
- That said, conditions across the economy are varied. Notably, mining investment is contracting and the local auto sector is soon to close.

Manufacturing & the business cycle

Westpac-AusChamber Composite & household demand

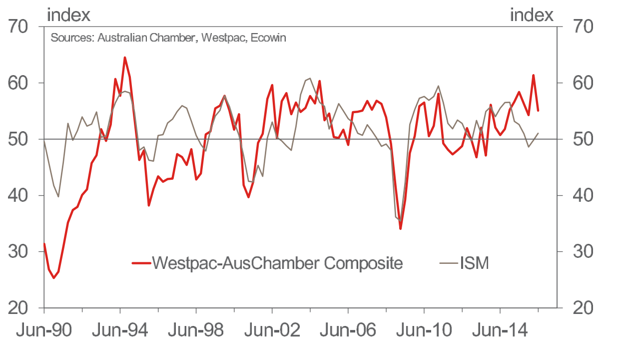


Australian & US manufacturing surveys

- The US and Australian manufacturing cycles have historically been highly synchronised, particularly at major turning points.
- In 2014, 2015 and into 2016, developments in monetary policy in the two countries and currency movements have been at odds. This has seen the manufacturing cycles diverge somewhat.
- The US dollar index strengthened as the US Federal Reserve delivered a rate hike on 16 December 2015, the first move since 2008. By contrast, the RBA resumed its easing cycle in the first half of 2015, followed by an additional rate cut in May 2016.
- US manufacturing has lost momentum. The ISM moderated from 56 at the end of 2014 to 49 late in 2015, with a partial rebound to around 51 in mid-2016.

Australian & US manufacturing surveys

Westpac-AusChamber & ISM Composite indexes

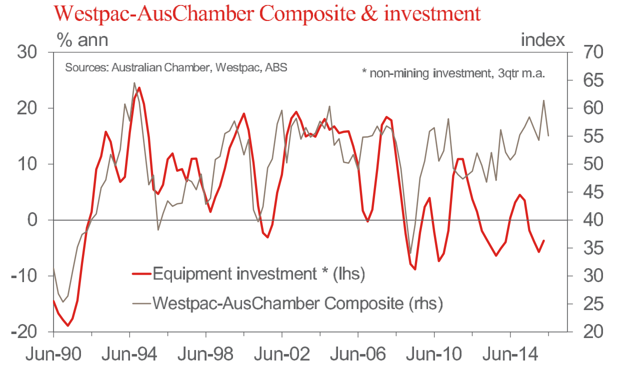


Manufacturing conditions & business investment

- The Westpac-AusChamber Composite historically has provided a broad guide to equipment investment. However, for much of the post-GFC period, such spending by the non-mining sector has been much weaker than predicted by the Composite.
- An atypical mix of growth in the initial aftermath of the GFC, with consumers taking more of a back seat; greater than usual uncertainty, both domestically and globally; and significant structural change in response to the high level of the Australian dollar prior to 2015; have all played a part in weaker investment outcomes.
- Official data reports that equipment investment spending by the non-mining sector weakened during 2015 and into 2016, reversing a modest improvement which emerged in 2014 and undershooting strength in household demand.

Activity & capital investment

Westpac-AusChamber Composite & investment



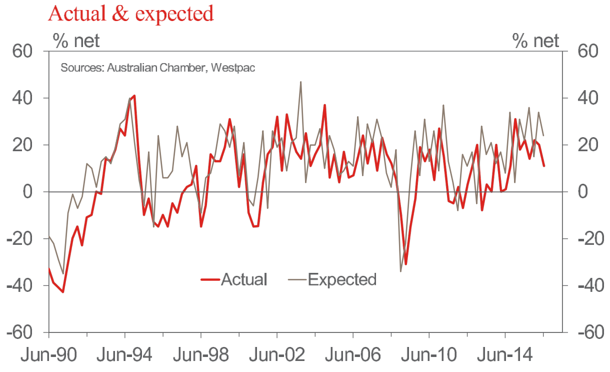
Activity & orders

Output

	Q1 2016	Q2 2016
Actual – net balance	20	11
Expected – net balance	34	24

- Manufacturing output advanced solidly for an eighth consecutive quarter, a trend that emerged during the second half of 2014 and has extended into 2016.
- In the June quarter, a net 11% of firms expanded output. That represents a moderation from a net 20% in March but is still above the long-run average, albeit modestly.
- While a cooling of conditions is apparent in June, expectations are relatively positive. A net 24% of respondents expect to lift output in the next three months.
- The RBA's decision to lower interest rates in May is a positive for the outlook. Having said that, the boost to the housing sector may be relatively modest and the peak in new home building activity is likely to be in 2016.

Output growth
Actual & expected

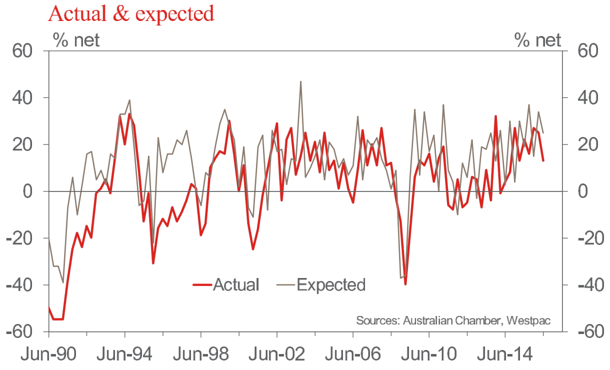


New orders

	Q1 2016	Q2 2016
Actual – net balance	25	13
Expected – net balance	34	25

- New orders increased materially for a seventh consecutive quarter, underpinning the lift in output.
- A net 13% of firms reported a rise in new orders. While a solid result, it falls short of the March outcome, +25%, and the 2015 average, +20%. Expectations are positive, with a net 25% anticipating a rise in the next three months.
- Rising new orders for the manufacturing sector is evidence of an uptrend in some aspects of domestic demand. This is notwithstanding weakness in overall domestic demand in Australia, centred on the downturn in mining investment.
- Home building activity is on the rise, although the rate of growth is moderating as the cycle approaches it's peak. Also, the lower currency is benefitting exporters and import competing firms.

New orders
Actual & expected

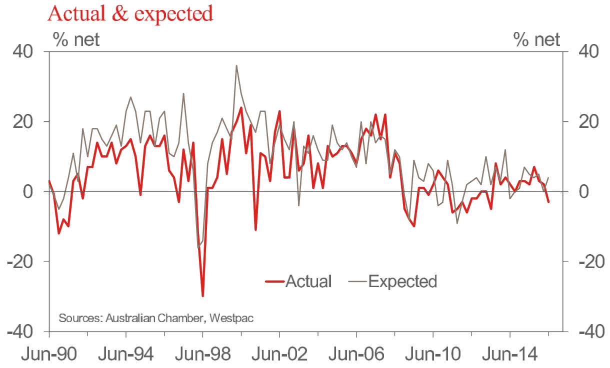


Exports

	Q1 2016	Q2 2016
Actual – net balance	2	–3
Expected – net balance	0	4

- Exports have advanced of late, albeit gradually. However, in June, the run of gains from late 2014 was broken. A net 3% of respondents reported a decline in export deliveries in the quarter. This fall follows a spike in the AUD to US77¢ and a volatile start to the year for financial markets. This slip in exports may well be short-lived with a net 4% expecting to increase shipments in the coming three months.
- The major plus is that the currency has moved sharply lower against the US dollar, down 20% from mid-2014. That has significantly boosted the competitiveness of Australian manufacturing, both exporters and import competing firms. However, world growth is sluggish having slowed in 2015, making for a challenging backdrop.

Export deliveries
Actual & expected



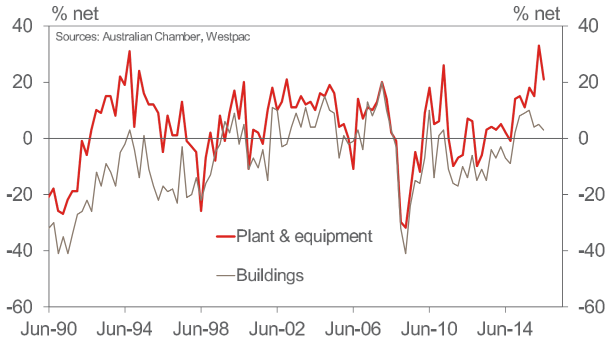
Investment & profitability

Investment intentions

	Q1 2016	Q2 2016
Plant & Equipment – net balance	33	21
Building – net balance	5	3

- The survey points, as it has since the end of 2014, to a turning point in equipment investment by the manufacturing sector.
- In June, a net 21% of respondents expect to increase spending on plant and equipment in the next twelve months. That is down from 33% in March, which was one of the strongest readings in the history of the survey.
- Consistent with this, the ABS capex survey reports that equipment spending by the sector grew by 9% in 2015, the first calendar year increase since the GFC.
- Building investment intentions are only slightly positive, with a net 3% expecting to increase spending, down from a net 5% in March.

Investment intentions
Next twelve months

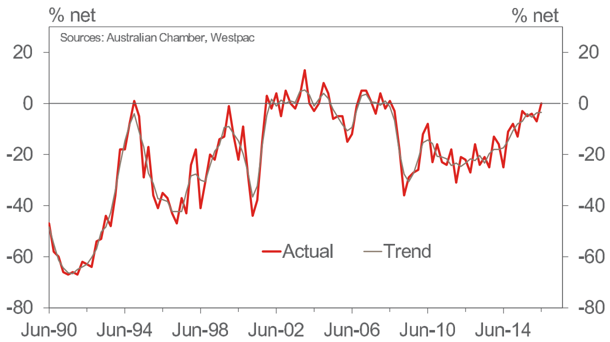


Capacity utilisation

	Q1 2016	Q2 2016
Net balance	–7	0

- Capacity utilisation levels have trended higher since late 2013.
- In the June quarter, the number of respondents operating at above normal capacity exactly offset those operating below normal. That outcome, along with the trend reading of a net -4%, evident over recent quarters, are the strongest since 2008, prior to the impact of the GFC.
- This trend is evidence that the upturn in conditions is absorbing some of the spare capacity in the sector. It points to a likely turning point in the investment cycle.

Capacity utilisation

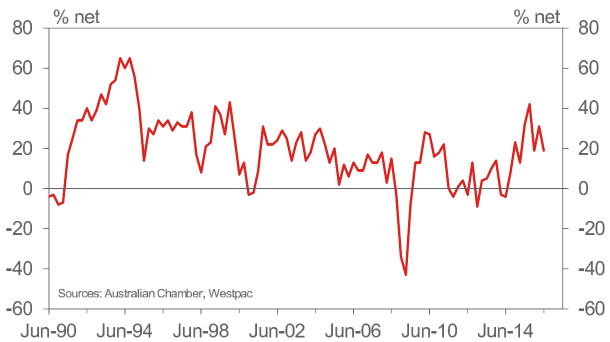


Profit expectations

	Q1 2016	Q2 2016
Net balance	31	19

- Firms are looking to 2016 to be a positive year for profits.
- A net 19% of respondents expect profitability to improve in the next twelve months.
- While that is a solid reading, matching the long-run average for this series, it is down from a net 31% in March. That is consistent with the moderation in orders and output reported by the survey.
- Equally, expectations that profitability will improve are consistent with the outlook for output expansion. In addition, the sharply lower dollar is boosting Australian dollar export earnings, although against that, imported inputs are more costly.

Profit expectations
Next twelve months



The labour market

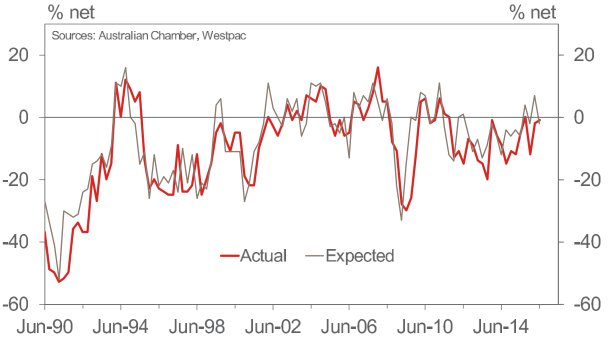
Numbers employed

	Q1 2016	Q2 2016
Actual – net balance	–2	–1
Expected – net balance	7	–2

- Manufacturers' views on hiring have strengthened since the middle of 2015.
- The survey found that in September 2015 the staff shedding of recent years gave way to a consolidation. While there was a backward step in December, with a reading of -12%, the March and June 2016 updates have been encouraging with only a net 2% and a net 1% of firms, respectively, having reduced their staffing levels over the past three months.
- Employment intentions also point to a broad consolidation in staffing numbers. In June, only a net 2% of firms expect to reduce their workforce over the next three months.

Numbers employed

Actual & expected



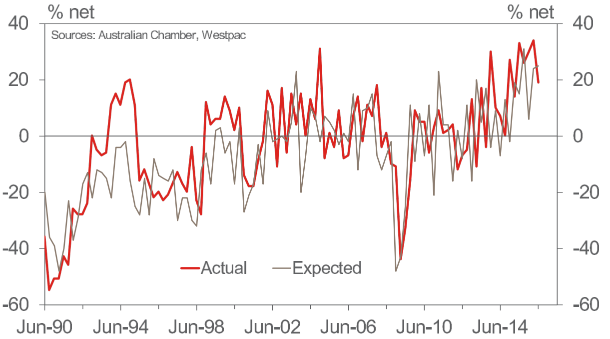
Overtime worked

	Q1 2016	Q2 2016
Actual – net balance	34	19
Expected – net balance	24	25

- Over the past two years, overtime has consistently been used by manufacturers to respond to rising new orders.
- In June, overtime again played a role, although not quite to the same extent as during the previous year. A net 19% of respondents increased overtime in June, a moderation from a net 34% in March. The less intense use of overtime is consistent with the finding that output growth moderated in mid-2016.
- For the coming three months, a net 25% of firms expect to increase overtime, in line with the view prevailing at the start of the year, a net 24%.

Overtime worked

Actual & expected

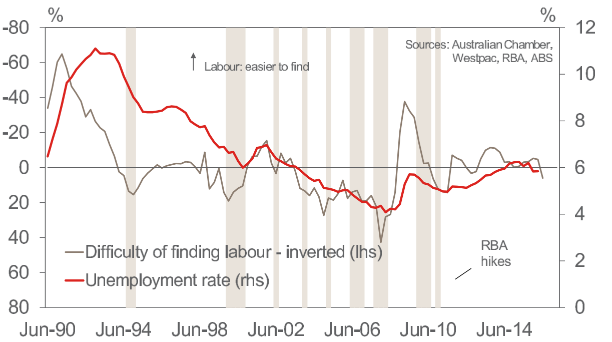


Difficulty of finding labour, seasonally adjusted

	Q1 2016	Q2 2016
Net balance	–4.5	6.0

- The survey provides insights into the tone of the overall labour market. Respondents' views on the difficulty of finding labour broadly tracks shifts in the unemployment rate for the Australian economy as a whole.
- In the June quarter, a net 6% of respondents reported labour as harder to find. That is a turnaround from recent quarters, where a net 3% to 5% found labour easier to find. This modest tightening of labour market conditions confirms trends in the official data.
- The ABS reports that the unemployment rate edged lower during 2015, from 6.2% to 5.8%, then held at this lower level in early 2016.

Labour market tightness



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

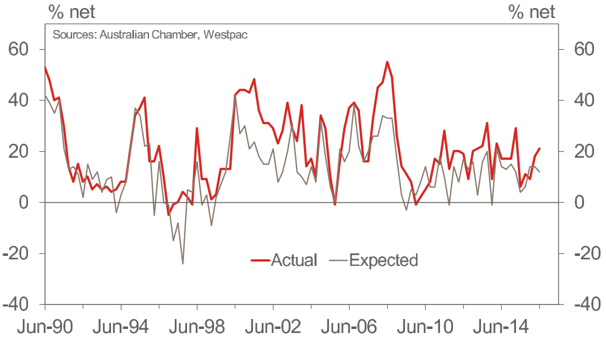
Prices & inflation

Average unit costs

	Q1 2016	Q2 2016
Actual – net balance	18	21
Expected – net balance	14	12

- Cost escalation moved modestly higher over the first half of 2016, against the backdrop of a bounce in commodity prices, up from historic lows. This follows a period in which cost rises had been a little less marked than is the norm.
- A net 21% of firms reported a rise in unit costs in June, up from 18% in March and 14% on average during 2015. The most recent outcome matches the decade average.
- More generally, it is notable that average cost pressures are relatively modest despite the sharp fall in the currency. This is further evidence of the lack of domestic inflation pressures in recent times, with weak wages growth a key dynamic.

Average unit costs
Actual & expected

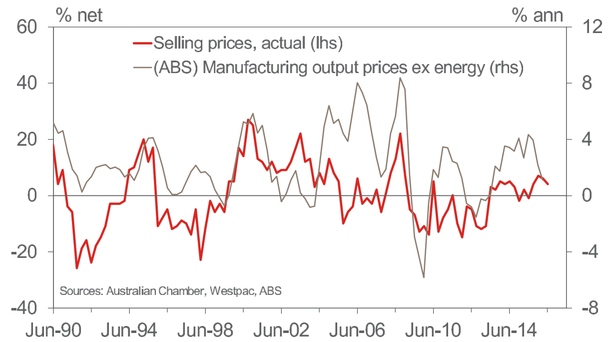


Average selling prices

	Q1 2016	Q2 2016
Actual – net balance	6	4
Expected – net balance	15	1

- Price rises for manufacturers have been more prevalent over the past year, in contrast to the lack of pricing power which is often the norm. In June, a net 4% of firms reported an increase in prices, following a net 6% in March.
- These results are most likely evidence that rising import costs are flowing through the pricing chain. Firms are unlikely to have the scope to fully absorb the impact of the 20% fall in the currency since mid-2014.
- Respondents anticipate little change in prices in the next three months, with only a net 1% expecting to be able to achieve a rise in their selling prices.

Manufacturing upstream price pressures

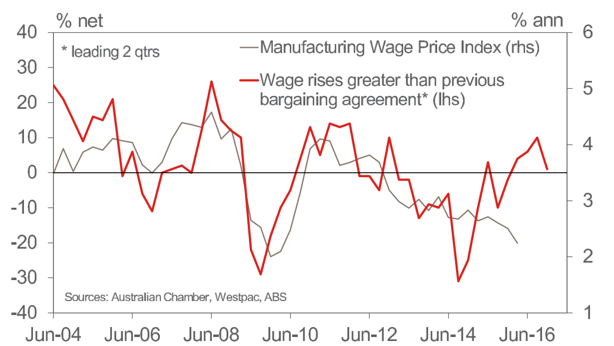


Manufacturing wages

	Q1 2016	Q2 2016
Net balance	10	1

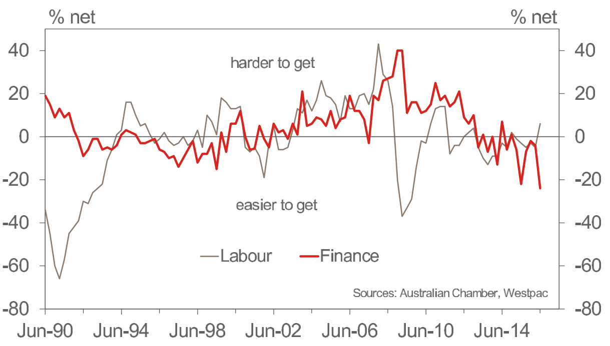
- The survey provides a guide to the outlook for manufacturing sector wages growth. Over the past few years, the survey correctly foreshadowed a marked slowing of wages growth.
- More recently, the survey points to a strengthening in wages growth to emerge in the year ahead. In June, a net 1% of firms expect their next wage deal to deliver an outcome above the last, a turnaround from mid-2015 when a net 2% expected lower outcomes for wage deals.
- The official data highlights that weak wages growth is a key feature of the broader Australian labour market, as well as the manufacturing sector. Notably, sharp falls in the terms of trade is squeezing incomes.

Manufacturing wage growth



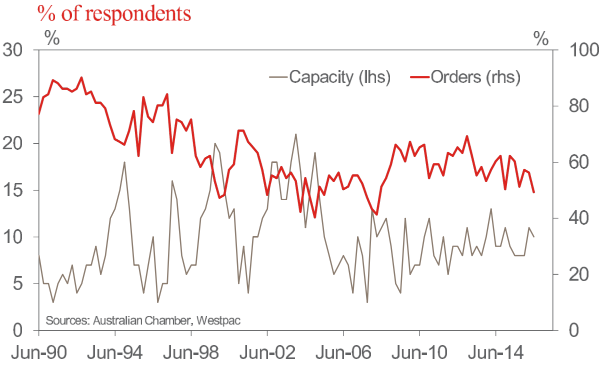
Other results

Availability of labour & finance



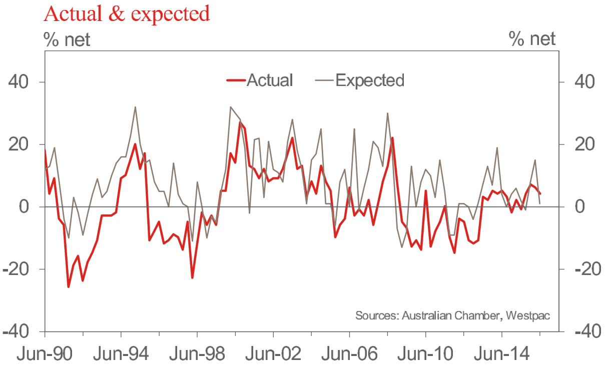
Key factor limiting production

% of respondents

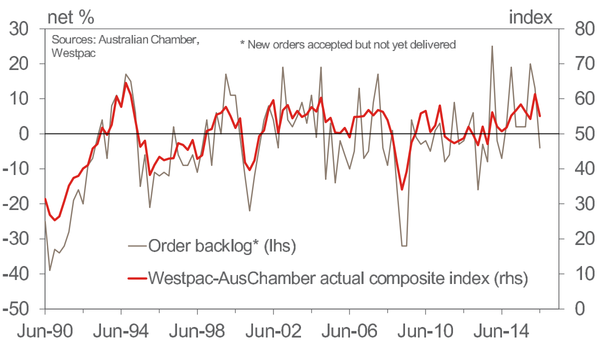


Average selling prices

Actual & expected

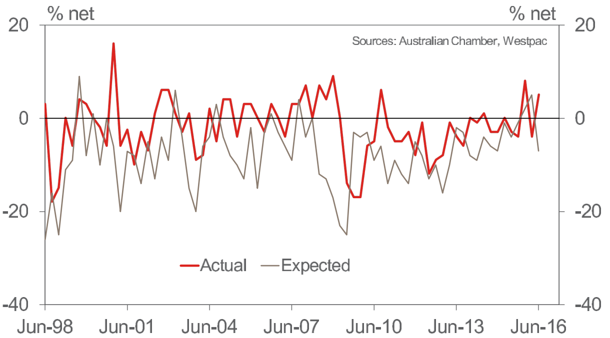


Order backlog & actual conditions



Stocks of finished goods

Actual & expected



Factors limiting production

	Q4 2015	Q1 2016	Q2 2016
Orders (%)	57	56	49
Capacity (%)	8	11	10
Labour (%)	3	3	2
Finance (%)	3	3	5
Materials (%)	1	1	1
Other (%)	17	19	20
None (%)	11	7	13

Summary of results

1. Do you consider that the general business situation in Australia will improve, remain the same, or deteriorate in the next six months?

Net balance	Improve	Same	Deteriorate
18	28	62	10

2. At what level of capacity utilisation are you working?

Net balance	Above Normal	Normal	Below Normal
0	17	66	17

3. What single factor is most limiting your ability to increase production?

None	13	Orders	49
Material	1	Finance	5
Labour	2	Capacity	10
Other	20		

4. Do you find it is now harder, easier, or the same as it was three months ago to get:

		Net balance	Harder	Same	Easier
(a)	labour?	6	11	84	5
(b)	finance?	−24	1	74	25

5. Do you expect your company's capital expenditure during the next twelve month to be greater, the same, or less than the past year:

		Net balance	Greater	Same	Less
(a)	on buildings?	3	13	77	10
(b)	on plant & machinery?	21	29	63	8

Excluding normal seasonal changes, what has been your company's experience over the past three months & what changes do you expect during the next three months in respect of:

	Change in position in the last 3 months				*Expected change during the next 3 months*			
	Net balance	**Improve**	**Same**	**Down**	**Net balance**	**Improve**	**Same**	**Down**
6. Numbers employed	−1	7	85	8	−2	6	86	8
7. Overtime worked	19	34	51	15	25	35	55	10
8. All new orders received	13	33	47	20	25	37	51	12
9. Orders accepted but not yet delivered	−4	13	70	17	10	21	68	11
10. Output	11	32	47	21	24	37	50	13
11. Average costs per unit of output	21	22	77	1	12	17	78	5
12. Average selling prices	4	12	80	8	1	10	81	9
13. Export deliveries	−3	2	93	5	4	5	94	1
14. Stock of raw materials	3	10	83	7	4	12	80	8
15. Stocks of finished goods	5	13	79	8	−7	5	83	12

Summary of results

16. Over the next twelve months do you expect your firm's profitability to:

(a) Improve?	31
(b) Remain unchanged?	57
(c) Decline?	12
Net balance	19

17. Do you expect your firm's next wage enterprise deal will produce annual rises which vis-a-vis the previous deal are:

(a) Greater?	9
(b) Same?	83
(c) Less?	8
Net balance	1

A. Industry profile of survey:

	(% of respondents)
Food, beverages, tobacco	14
Textiles, fabrics, floor coverings, felt, canvas, rope	5
Clothing, footwear	8
Wood, wood products, furniture	5
Paper, paper products, printing	9
Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products	12
Non-metallic mineral products: glass, pottery, cement bricks	2
Basic metal products: processing, smelting, refining, pipes & tubes	2
Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools	12
Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs	7
Other machinery & equipment: electrical, industrial scientific, photographic	14
Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery	10

B. How many employees are covered by this return?

1-100	**101-200**	**201-1000**	**Over 1000**
59	7	20	14

C. In which state is the main production to which this return relates?

WA	**SA**	**VIC**	**NSW/ACT**	**QLD**	**TAS**
10	8	21	44	12	5

The Westpac-AusChamber Composite Indices

The Westpac-AusChamber Actual and Expected Composite indices are weighted averages of the activity measures in the survey. The weights are as follows: employment 20%; new orders 30%; output 25%; orders accepted but not delivered 15%; overtime 10%.

The labour demand indicator is a weighted average of current and expected labour indicators from the survey. The indicator is expressed as a detrended net balance. Approximate weights are as follows: employment 40%; expected employment 20%; overtime 30%; and expected overtime 10%.

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