Australian Chamber of Commerce and Industry

Westpac GROUP

Australian Chamber–Westpac Survey of Industrial Trends

Australian Chamber of Commerce and Industry & Westpac Banking Corporation

218th report March 2016 (survey conducted 29 January to 7 March 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 strengthened in the March quarter to 61.4, up 7.1pts, from 54.3 in December and from 56.4 on average in 2015.
- The trend strengthening of the Composite index in 2015 and into 2016 is evident across new orders, output, order backlog, overtime, and an emerging broadening to employment.
- Manufacturing is benefitting from a strong upswing in new home building activity, as well as the lift in renovation activity and from the significant improvement in competitiveness flowing from the sharply lower currency, down 25% against the US dollar since mid-2014. Also, consumer spending gained momentum to a slightly above trend pace over the second half of 2015. Even so, the cycle remains constrained. Mining investment is turning down sharply and global fragilities persist.
- Exports are rising modestly, supported by the lower currency but are constrained by still sluggish world growth. A net 2% of firms reported a lift in exports.
- Expectations are positive, centred on new orders and output. Firms expect to respond to this strength by expanding their workforce, as well as increased overtime. The Expected Composite index is at 58.8, down 1.0pt on December. A net 15% expect the general business environment to strengthen over the next six months, an upbeat mood, albeit moderating from 38% in December.
- Businesses are looking to 2016 to be a positive year for profitability, driven by increased turnover and a lower Australian dollar boosting export returns. A net 31% expect profits to increase.
- Investment intentions have strengthened, consistent with an extended trend reduction in the sector's spare capacity and improving profitability. A net 33% of firms expect to increase equipment spending in the next year. Investment plans for building investment are more muted, at a net +5%.
- The survey's Labour Market composite rose to 56.9 in March, to average 55 over the past six months, up from 51 a year ago. The Index correctly foreshadowed the strengthening in economy wide jobs growth evident over the past year. It points to further solid gains in 2016.

Contents

The Survey of Industrial Trends produced by the Australian Chamber of Commerce and Industry & Westpac Banking Corporation is a quarterly publication.

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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 218th consecutive survey was closed on 7 March 2016.
A total of 317 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 May/June 2016.

Key survey results

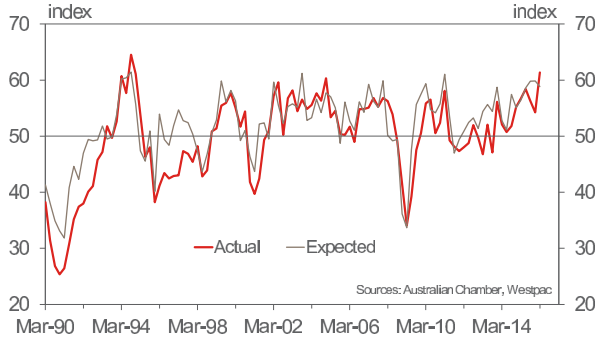
Westpac–AusChamber composites, seasonally adj.

	Q4 2015	Q1 2016
Actual – composite index	54.3	61.4
Expected – composite index	59.8	58.8

- The Westpac-AusChamber Actual Composite index strengthened in the March quarter, to 61.4, up from 54.3 in December and from 56.4 on average in 2015. Strength is evident across each component of the index: new orders; output; order backlog; overtime; and an emerging broadening to employment.
- Manufacturing is benefitting from the significant easing of monetary conditions. Home building is in the midst of a strong upswing in response to historic low interest rates. The sharply lower dollar is benefitting exporters and import competing firms, including food manufacturing.
- The Expected Composite index moderated by 1pt in March, but was still elevated at 58.8. Expectations are for stronger orders and output, as well as overtime and employment.

Westpac-AusChamber composite indexes

Actual & expected, sa

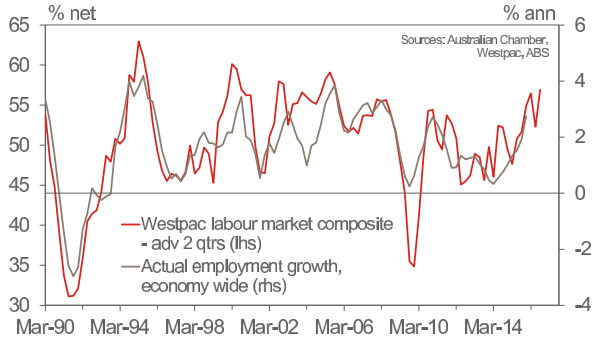


Westpac–AusChamber labour market composite

	Q4 2015	Q1 2016
Net balance	52.3	56.9

- The Westpac-AusChamber Labour Market Composite index strengthened in the March quarter, to 56.9, up from 52.3 in December. The average reading of the past six months of around 55 is up from 51 a year ago.
- In this cycle, the Labour Market Composite has once again proven itself to be a reliable lead indicator of Australia's economy wide jobs growth. This highlights the key linkages between manufacturing and the household sector.
- Official data reports that employment across Australia grew by 2.75% in the year to the December quarter, accelerating from 1.0% at the end of 2014, as foreshadowed by the Labour Market Composite.
- The survey points to solid jobs growth extending well into 2016.

Employment momentum extends into 2016



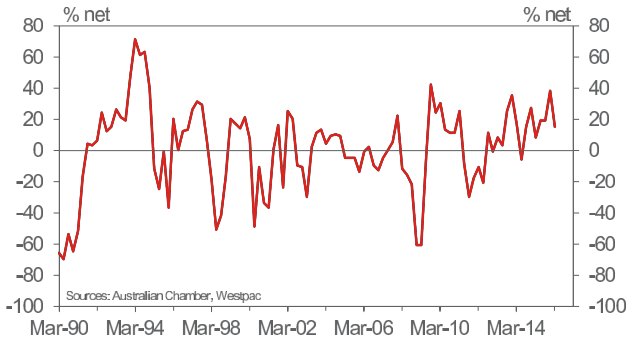
General business situation

	Q4 2015	Q1 2016
Net balance	38	15

- The manufacturing sector is thinking positively early in 2016. In the March quarter, a net 15% of respondents expect the general business environment to strengthen over the next six months. While upbeat this is down from a net 38% in December and 21% on average for 2015.
- As well as the strong home building upswing, a major plus is the sharply lower currency, at US70-72¢ early in 2016. That is down almost 25% from mid-2014 and is the lowest level since the GFC and before that 2006.
- Consistent with this positive mood around the general business environment, the Westpac-AusChamber Expectations Composite remained elevated, at 58.8, albeit down 1pt from the end of 2015.

General business situation

Next six months



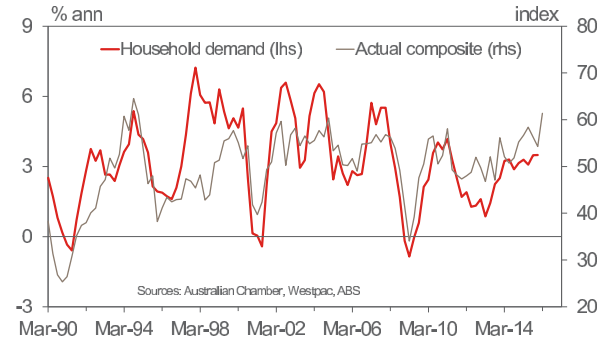
The business cycle & economic outlook

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 accelerated to be a little above trend in 2015, at 3.5%, up from 3.1% for 2014 and 2.5% for 2013.
- That said, conditions across the economy are varied. Business investment is falling and the local auto sector is soon to close.

Manufacturing & the business cycle

Westpac-AusChamber composite & household demand

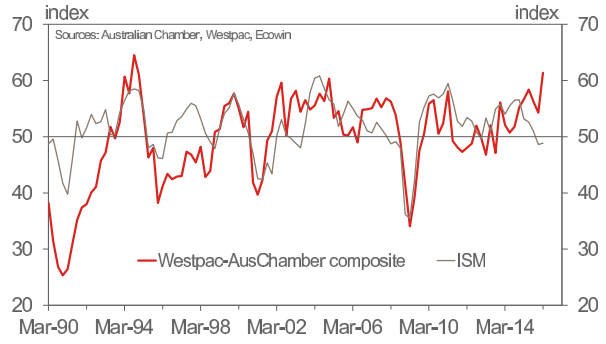


Australian & US manufacturing surveys

- The US and Australian manufacturing cycles have historically been highly synchronised, particularly at major turning points.
- In 2014 and 2015, 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 and has maintained an easing bias.
- US manufacturing has lost momentum. The ISM moderated from 56 at the end of 2014 to 49 late 2015, early 2016.

Australian & US manufacturing surveys

Westpac-AusChamber & ISM composite indexes

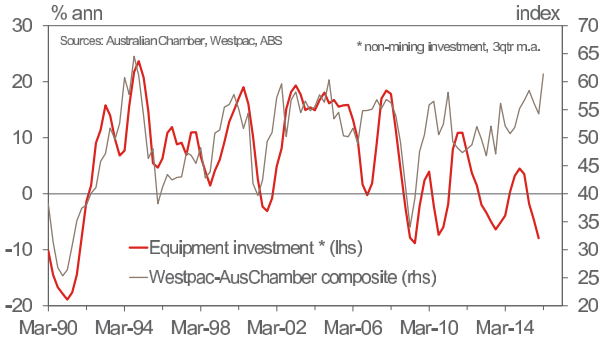


Manufacturing conditions & business investment

- 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.
- The official data reports that equipment investment spending by the non-mining sector weakened during 2015, reversing a modest improvement which emerged in 2014 and undershooting strength in household demand.

Activity & capital investment

Westpac-AusChamber composite & investment



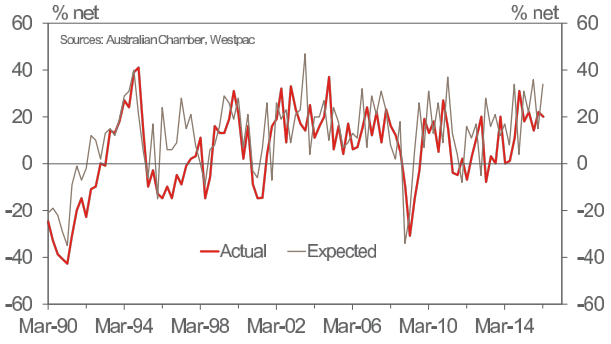
Activity & orders

Output

	Q4 2015	Q1 2016
Actual – net balance	22	20
Expected – net balance	15	34

- Manufacturing output advanced solidly for a seventh consecutive quarter, a trend that emerged during the second half of 2014 and has extended into 2016.
- In the March quarter, a net 20% of firms expanded output. This matches levels prevailing during 2015 and is above the long-run average.
- Currently, the above average strength reflects fewer respondents recording a deterioration than is the norm, rather than an atypical number reporting an increase. Arguably this is consistent with the lack of synchronised strength across the Australian economy.
- The survey points to this expansion in output continuing. A net 34% expect to lift output in the next three months.

Output growth
Actual & expected

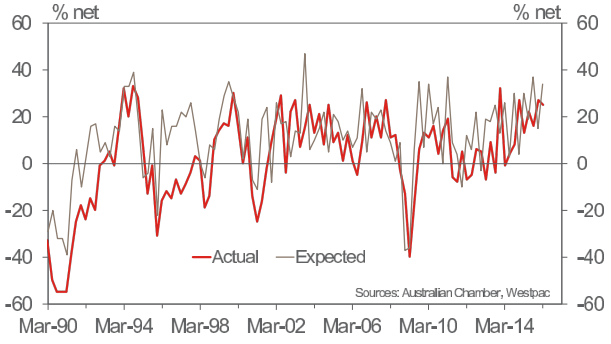


New orders

	Q4 2015	Q1 2016
Actual – net balance	27	25
Expected – net balance	15	34

- New orders increased materially for a sixth consecutive quarter, underpinning the lift in output. A net 25% of firms reported a rise in new orders, broadly in line with the result of three months ago. Moreover, expectations are positive, with a net 34% expecting a further increase in orders 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 growing at a double digit rate and while approvals are down from their 2015 peak the pipeline of work remains sizeable. Also, the lower currency is benefitting exporters and import competing firms.

New orders
Actual & expected

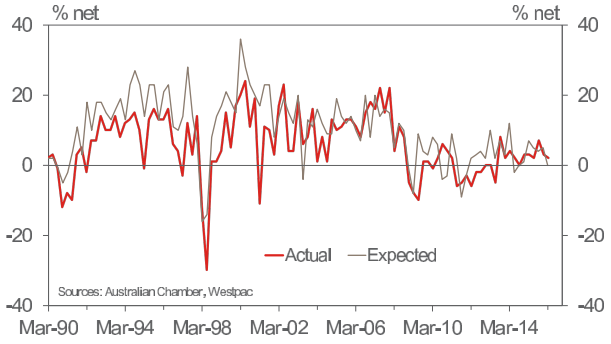


Exports

	Q4 2015	Q1 2016
Actual – net balance	3	2
Expected – net balance	5	0

- Exports are advancing, albeit only gradually. A net 2% of respondents reported increasing export deliveries in the March quarter and, surprisingly, expectations have moderated from a net 5% in December to a flat reading in this update. It may be that heightened global uncertainty early in 2016 weighed on sentiment.
- The major plus is that the currency has moved sharply lower against the US dollar. Since mid-2014, the currency is down 25% to be at US70-72¢ over the initial two months of 2016. This has significantly boosted the competitiveness of Australian manufacturing, both exporters and import competing firms. However, world growth is sluggish and slowed in 2015, making for a challenging backdrop.

Export deliveries
Actual & expected



Investment & profitability

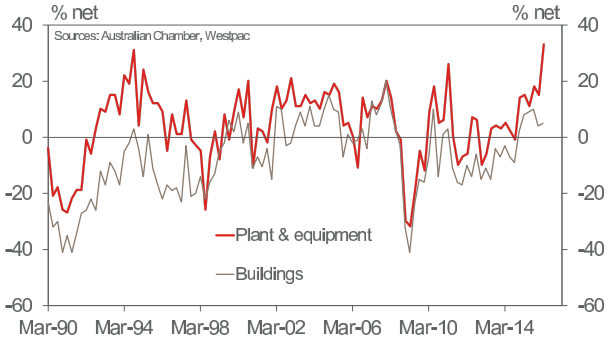
Investment intentions

	Q4 2015	Q1 2016
Plant & Equipment – net balance	15	33
Building – net balance	4	5

- The survey suggests that the downturn in investment by the manufacturing sector may be nearing its low point.
- In March, a net 33% of respondents expect to increase spending on plant and equipment in the next twelve months. This is one of the strongest readings in the history of this survey and the first "strong read" since 2011.
- In this instance, more firms are looking to increase spending, whereas positive readings over recent quarters were centred on fewer firms looking to reduce investment.
- By contrast, building investment intentions cooled over the past six months, with a net 5% expecting to increase spending, moderating from +9% for much of 2015.

Investment intentions

Next twelve months

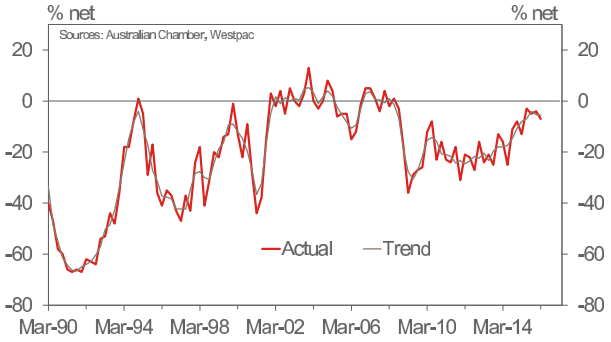


Capacity utilisation

	Q4 2015	Q1 2016
Net balance	–4	–7

- Capacity utilisation levels have trended higher since late in 2013.
- In the March quarter, only a net 7% of firms reported operating below normal capacity. The trend reading of a net -5%, evident over recent quarters, is the strongest since 2008, prior to the impact of the GFC.
- This trend has been driven by fewer firms operating below normal capacity, rather than more operating above capacity - a mix that is consistent with the survey's results around output performance.
- This 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



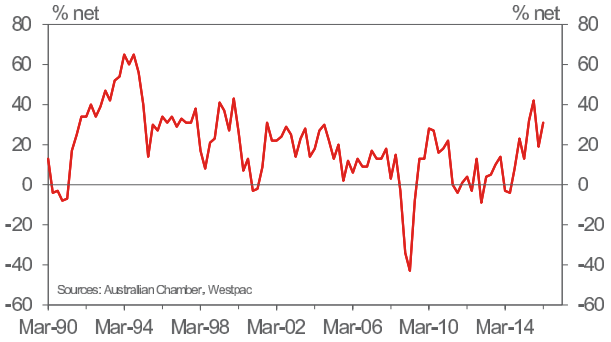
Profit expectations

	Q4 2015	Q1 2016
Net balance	19	31

- Firms are looking to 2016 to be a positive year for profits.
- A net 31% of respondents expect profitability to improve in the next twelve months. This is broadly in line with the views prevailing over the past five quarters, with an average reading of 26%.
- This optimism is in response to the improved economic backdrop. Profitability has increased on the lift in turnover over recent quarters. 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

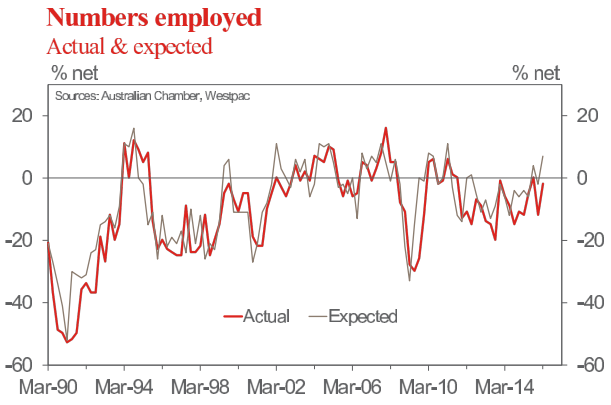


The labour market

Numbers employed

	Q4 2015	Q1 2016
Actual – net balance	–12	–2
Expected – net balance	–2	7

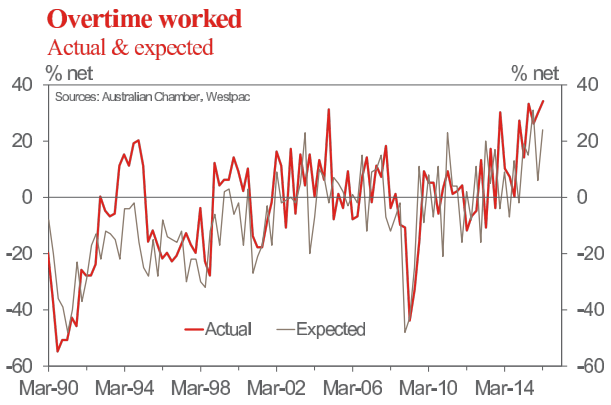
- Manufacturers' views on hiring have strengthened since the middle of 2015.
- In the September quarter 2015, the staff shedding of recent years gave way to a consolidation. While there was a backward step in December, with a reading of -12%, the March update is encouraging in that only a net 2% of firms reduced their staffing levels over the past three months.
- In addition, employment intentions have turned positive. Firms expect to grow their workforce over the next three months in response to rising production. This, and a net 4% reading for September 2015, are the strongest results since the period of 2010 to 2011.



Overtime worked

	Q4 2015	Q1 2016
Actual – net balance	30	34
Expected – net balance	6	24

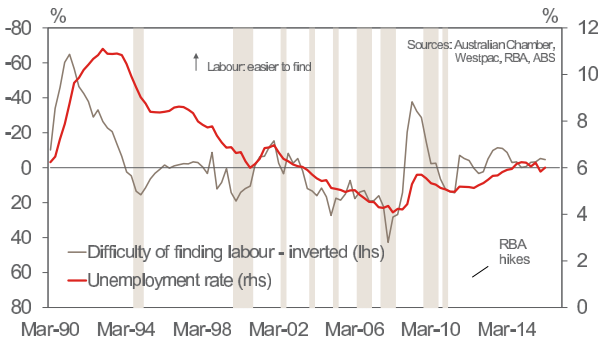
- Recently, overtime has been the key swing factor for manufacturers in response to fluctuations in new orders from quarter to quarter.
- In March, overtime again played a role. A net 34% of respondents increased overtime, in line with the experience of the past three quarters.
- For the coming three months, a net 24% of firms expect to increase overtime, a reading in line with those prevailing for the bulk of 2015. This is in addition to an expectation that firms will grow their workforce in the next quarter.



Difficulty of finding labour, seasonally adjusted

	Q4 2015	Q1 2016
Net balance	–5.2	–4.5

- 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 March quarter, a net 5% of respondents reported labour as easier to find, matching the December result and being not materially different from recent quarters.
- Official labour market data for this period has been a little more upbeat. The unemployment rate edged lower during 2015, from 6.2% to 5.8%, although it subsequently rebounded to 6.0% in January 2016.



Prices & inflation

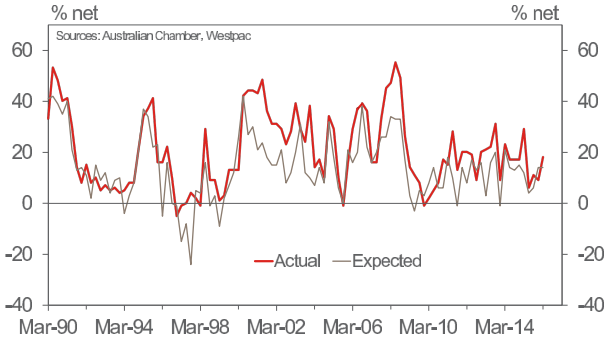
Average unit costs

	Q4 2015	Q1 2016
Actual – net balance	9	18
Expected – net balance	14	14

- Cost escalation has generally been a little less marked in recent times than is the norm.
- A net 18% of firms reported a rise in unit costs in March. While that is up from a net 9% in December, possibly reflecting some price resetting to begin the new year, it is still below the decade average of 21%.
- Average cost pressures are relatively modest despite the sharp fall in the Australian dollar. 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

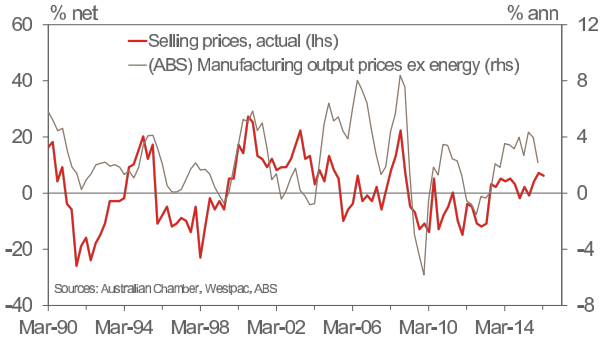


Average selling prices

	Q4 2015	Q1 2016
Actual – net balance	7	6
Expected – net balance	8	15

- Price rises for manufacturers have been more prevalent over the past nine months, in contrast to the lack of pricing power which is often the norm. In March, a net 6% of firms reported an increase in prices, following a net 7% in December and a net 4% in September.
- These results are most likely evidence that rising import costs are flowing through the pricing chain to consumers. Firms are unlikely to have the scope to fully absorb the impact of the 25% fall in the currency since mid-2014.
- Respondents expect a further adjustment, with a net 15% expecting prices to rise in the June quarter.

Manufacturing upstream price pressures



Manufacturing wages

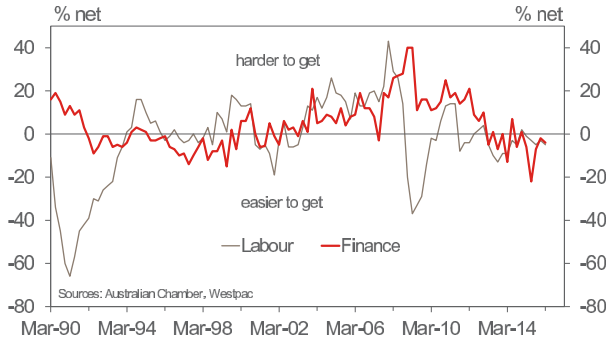
	Q4 2015	Q1 2016
Net balance	6	10

- 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 is pointing to a strengthening in wages growth to emerge in the year ahead.
- In the March quarter, a net 10% of firms expect their next wage deal to deliver an outcome above the last, up from 6% and the third consecutive reading above zero.
- To date, the official data highlights that weak wages growth is a key feature of the broader Australian labour market, as well as the manufacturing sector. The sharp fall in the terms of trade is squeezing national incomes.

Manufacturing wage growth

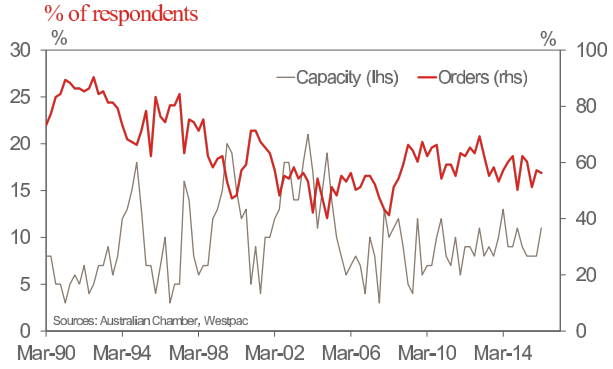
Other results

Availability of labour & finance



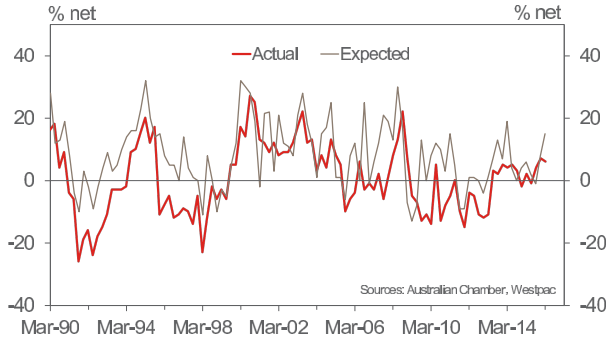
Key factor limiting production

% of respondents

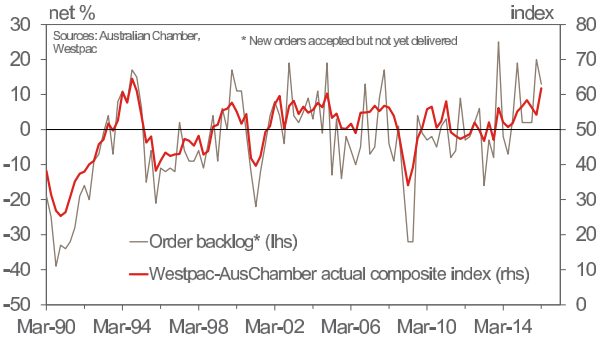


Average selling prices

Actual & expected

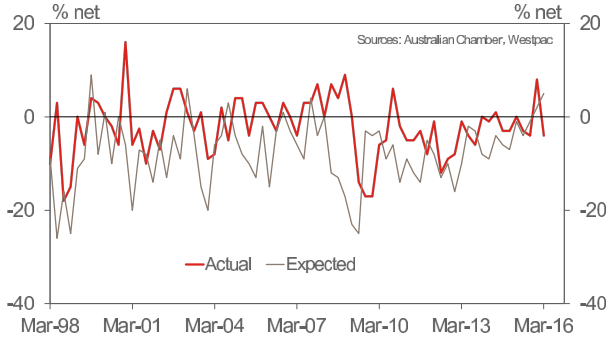


Order backlog & actual conditions



Stocks of finished goods

Actual & expected



Factors limiting production

	Q3 2015	Q4 2015	Q1 2016
Orders (%)	51	57	56
Capacity (%)	8	8	11
Labour (%)	2	3	3
Finance (%)	3	3	3
Materials (%)	3	1	1
Other (%)	24	17	19
None (%)	9	11	7

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
15	28	59	13

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

Net balance	Above Normal	Normal	Below Normal
-7	8	77	15

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

None	7	Orders	56
Material	1	Finance	3
Labour	3	Capacity	11
Other	19		

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?	-5	2	91	7
(b)	finance?	-4	3	90	7

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?	5	14	77	9
(b)	on plant & machinery?	33	40	53	7

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	-2	10	78	12	7	11	85	4
7.	Overtime worked	34	40	54	6	24	35	54	11
8.	All new orders received	25	36	53	11	34	42	50	8
9.	Orders accepted but not yet delivered	13	21	71	8	14	23	68	9
10.	Output	20	31	58	11	34	41	52	7
11.	Average costs per unit of output	18	21	76	3	14	18	78	4
12.	Average selling prices	6	11	84	5	15	19	77	4
13.	Export deliveries	2	4	94	2	0	2	96	2
14.	Stock of raw materials	-1	10	79	11	9	14	81	5
15.	Stocks of finished goods	-4	10	76	14	5	13	79	8

Summary of results

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

(a) Improve?	39
(b) Remain unchanged?	53
(c) Decline?	8
Net balance	31

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?	15
(b) Same?	80
(c) Less?	5
Net balance	10

A. Industry profile of survey:

	(% of respondents)
Food, beverages, tobacco	15
Textiles, fabrics, floor coverings, felt, canvas, rope	4
Clothing, footwear	9
Wood, wood products, furniture	3
Paper, paper products, printing	7
Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products	14
Non-metallic mineral products: glass, pottery, cement bricks	6
Basic metal products: processing, smelting, refining, pipes & tubes	2
Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools	10
Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs	6
Other machinery & equipment: electrical, industrial scientific, photographic	15
Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery	9

B. How many employees are covered by this return?

1-100	**101-200**	**201-1000**	**Over 1000**
53	7	23	17

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

WA	**SA**	**VIC**	**NSW/ACT**	**QLD**	**TAS**
12	9	21	42	11	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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