

# Australian Chamber–Westpac Survey of Industrial Trends

Australian Chamber of Commerce and Industry & Westpac Banking Corporation

**220<sup>th</sup> report September 2016** (survey conducted 8 August to 2 September 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 rebounded in the September quarter to 57.3, up 2.3pts. That returns the index to a level in line with the average for 2015.
- 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 a lift in renovation activity and a significant improvement in competitiveness flowing from the sharply lower currency, down 28% against the US dollar from the highs of early 2013. Even so, the cycle remains constrained. Mining investment is turning down sharply and global fragilities persist. Consumer spending was solid over the past year, but remains far from strong.
- The modest uptrend in exports appears to have stumbled in 2016, with respondents reporting export deliveries were unchanged in September. Expectations are for the uptrend to resume, supported by the relatively low AUD, but are constrained by sluggish world growth and weak world trade.
- Expectations are positive, centred on new orders and output. Firms intend to respond to this strength by increasing overtime and, at the margin, adding to their existing workforce. The Expected Composite index is at 60.4, down only 0.6pts from June. A net 25% expect the general business environment to strengthen over the next six months, an upbeat mood, up from a net 18% in June.
- Businesses are looking to 2017 to be a positive year for profits, driven by rising turnover and a lower Australian dollar boosting export returns. A net 25% expect profits to rise in the 12 months ahead.
- Equipment investment intentions strengthened over the past two years, consistent with a 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, a net +8%.
- The survey's Labour Market Composite rebounded in September to a positive 57.6. The Index, which correctly foreshadowed the strengthening in economy wide jobs growth evident during 2015, points to solid job gains over the remainder of 2016 and into 2017.

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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 220<sup>th</sup> consecutive survey was closed on 2 September 2016.

A total of 304 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 November/December 2016.

# Key survey results

## Westpac–AusChamber Composites *(seasonally adjusted)*

	Q2 2016	Q3 2016
Actual – composite index	55.0	57.3
Expected – composite index	61.0	60.4

- The Westpac-AusChamber Actual Composite index rebounded in the September quarter, to 57.3, up from 55.0 in June, to be broadly 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 has responded strongly to record low interest rates. The sharply lower dollar is benefitting exporters and import competing firms. Also, more recently, public investment is on the rise.
- The Expected Composite index consolidated at a high level, at 60.4, after a 61.0 in June. Expectations are for stronger orders and output, as well as overtime.

## Westpac–AusChamber Labour Market Composite

	Q2 2016	Q3 2016
Net balance	54.8	57.6

- The Westpac-AusChamber Labour Market Composite index rebounded in September, to 57.6, reversing the dip to 54.8 in June. This is an elevated level and is a little above the highs of the past year.
- 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 Australian economy wide employment grew by 2.7% in 2015, accelerating from 1.0% in 2014, as foreshadowed by the Labour Market Composite. In 2016, while jobs growth slowed to a 1% pace over the first half of the year, the survey points to a lift in momentum over the remainder of the year and into 2017.

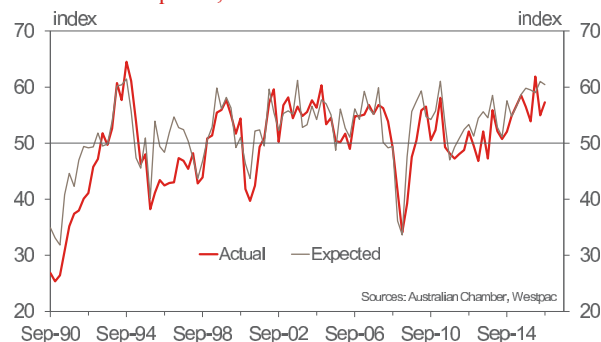
## General business situation

	Q2 2016	Q3 2016
Net balance	18	25

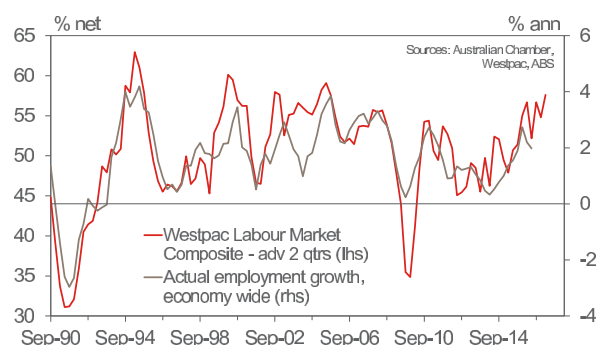
- The manufacturing sector is thinking positively in 2016. In the September quarter, a net 25% of respondents expect the general business environment to strengthen over the next six months. That is up from 18% in June. Consistent with this, the Westpac-AusChamber Expectations Composite is elevated, at 60.4.
- The Reserve Bank has delivered yet more rate cuts in 2016, moving in May and August. As well as the strong home building upswing, a major plus is the sharply lower currency, at around US75¢ over recent months. That is 28% below levels seen in early 2013. More recently, state governments are committing to new projects, including in transport.

## Westpac-AusChamber Composite indexes

Actual & expected, sa

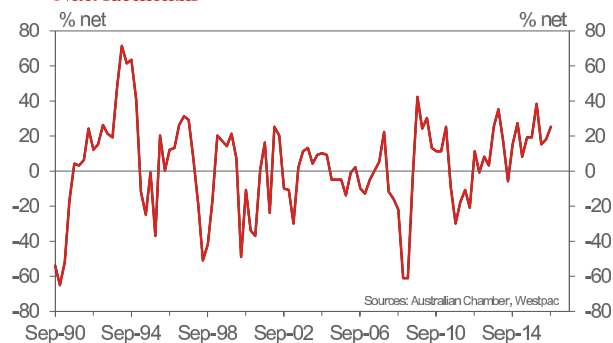


## Employment momentum extends into 2016



## General business situation

Next six months



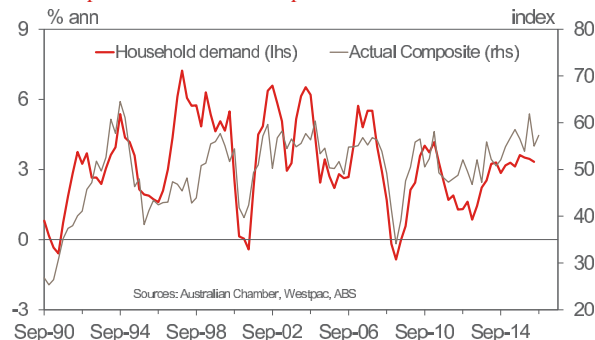
# The business cycle & economic outlook

## Manufacturing & the business cycle

- The Westpac-AusChamber Actual Composite has a solid track record of predicting near-term domestic economic conditions, including identifying turning points in the cycle.
- The Composite tracks movements in household demand, highlighting the key linkages between the consumer, home building (both new and renovations) 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 solid 3.3% in mid-2016, 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 winding down.

## Manufacturing & the business cycle

Westpac-AusChamber Composite & household demand

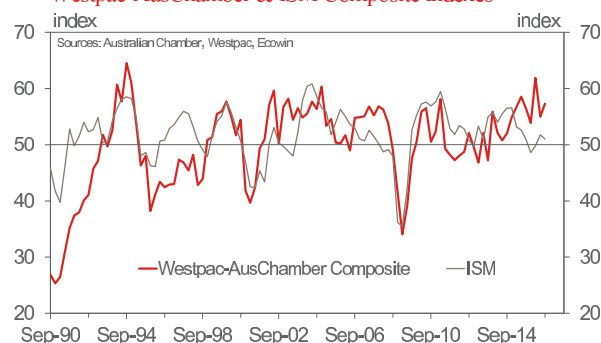


## Australian & US manufacturing surveys

- 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 additional rate cuts in May and August 2016.
- US manufacturing has lost momentum. The ISM moderated from 56 at the end of 2014 to 49 late in 2015 and has averaged 51 in 2016 Q3, including a 49.4 in August.

## Australian & US manufacturing surveys

Westpac-AusChamber & ISM Composite indexes

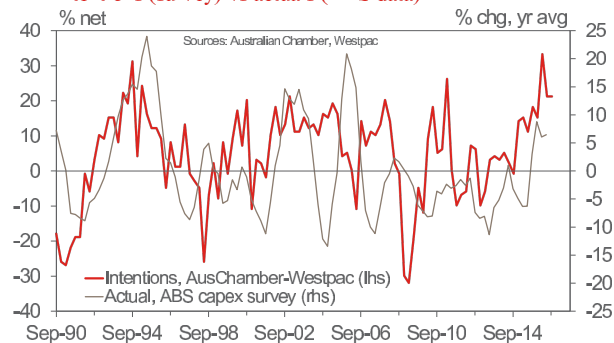


## Manufacturing & business investment

- The AusChamber-Westpac survey has a solid track recording of predicting equipment investment by the manufacturing sector.
- Since late 2014, the survey has pointed to an upswing in equipment investment in the manufacturing sector, with respondents indicating an intention to increase spending on equipment in the year ahead.
- The official ABS capex survey reports that an upswing in manufacturing equipment investment is underway, increasing in June 2016 by 6.5%, in year average terms, the strongest result since 2006.
- More generally, investment cycles across the economy are desynchronised. A key ongoing dynamic is the mining investment boom and its subsequent unwinding, including negative spill-over effects to sectors servicing mining.

## Manufacturing equipment investment

Intentions (survey) vs actuals (ABS data)



# Activity & orders

## Output *(seasonally adjusted)*

	Q2 2016	Q3 2016
Actual – net balance	14	20
Expected – net balance	28	32

- Manufacturing output advanced solidly for a ninth consecutive quarter, a trend that emerged during the second half of 2014 and has extended into 2016.
- In September, a net 20% of firms expanded output, in line with the 2015 average. That represents a partial rebound from June, when conditions may have been constrained by uncertainty ahead of the July Federal election.
- Expectations are positive, with a net 32% expecting to lift output in the next three months.
- The RBA's decision to lower interest rates in May and again in August will act to support domestic conditions, including in housing. Renovation activity, which was patchy in 2015, is moving ahead in NSW and Victoria in 2016.

## New orders *(seasonally adjusted)*

	Q2 2016	Q3 2016
Actual – net balance	15	20
Expected – net balance	30	27

- New orders increased materially for a ninth consecutive quarter, underpinning the lift in output.
- A net 20% of firms reported a rise in new orders, up from 15% in June, to be in line with the 2015 average.
- Expectations have remained elevated at a net +27% in September, following +30% in June. Although, of late, expectations have proven to be a little too optimistic.
- Rising new orders for manufacturing 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. Also, the lower currency is benefitting exporters and import competing firms.

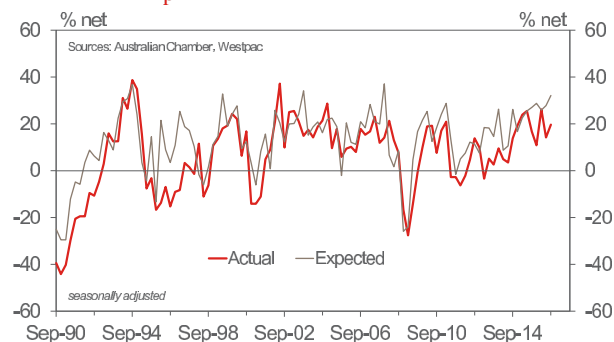
## Exports

	Q2 2016	Q3 2016
Actual – net balance	-3	0
Expected – net balance	4	2

- The survey suggests that the recent export upswing stumbled in 2016 against a backdrop of weak world trade.
- In September, the number of respondents reporting a rise in export deliveries matched those reporting a decline. That follows a net -3% in June. From the second half of 2013 through to early 2016, exports advanced consistently, albeit at a gradual pace.
- A net 2% of firms expect to increase exports in the coming three months, although the positive expectations in the June survey, a net +4%, were not met. The currency is still at a relatively low level, but has been more volatile of late.

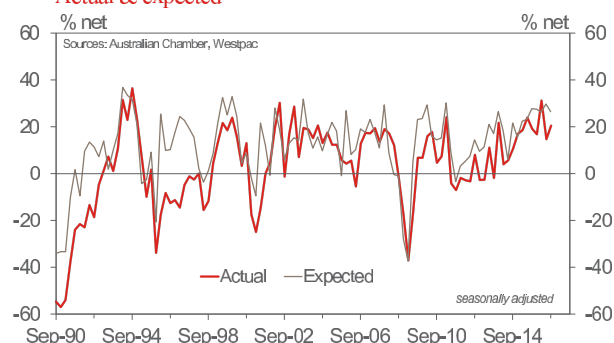
## Output growth

### Actual & expected



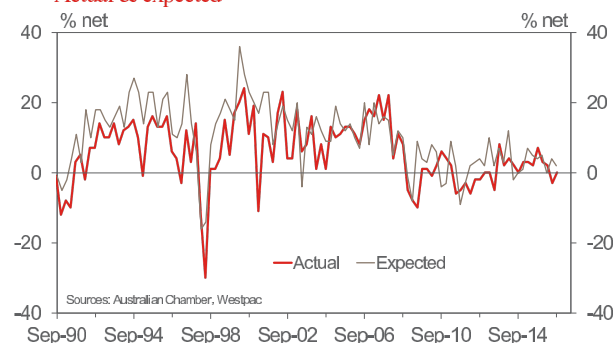
## New orders

### Actual & expected



## Export deliveries

### Actual & expected



# Investment & profitability

## Investment intentions

	Q2 2016	Q3 2016
Plant & Equipment – net balance	21	21
Building – net balance	3	8

- The survey, as it has since late 2014, points to an upswing in equipment investment in the manufacturing sector.
- In September, a net 21% of respondents expected to increase spending on plant and equipment in the next twelve months. This result, which is unchanged from June, is elevated by historical standards.
- Notably, for June 2016, the official ABS capex survey reports that actual manufacturing equipment investment increased by 6.5%, in year average terms, the strongest result since 2006 (see chart on page 5).
- Building investment intentions are less upbeat, with a net 8% expecting to increase spending, although that is an improvement on a net 3% in June.

## Capacity utilisation

	Q2 2016	Q3 2016
Net balance	0	-7

- Capacity utilisation levels trended higher from late 2013, although they have consolidated over the past year.
- In the September quarter, the number of respondents operating above normal capacity was less than those operating below by a net -7%. That is slightly below the average over the past year, but well up from the net -20% readings prior to mid-2014.
- Looking over recent years, this trend is evidence that the upturn in conditions is absorbing some of the spare capacity in the sector.
- More recently, the upswing in equipment investment has been adding capacity to meet rising demand.

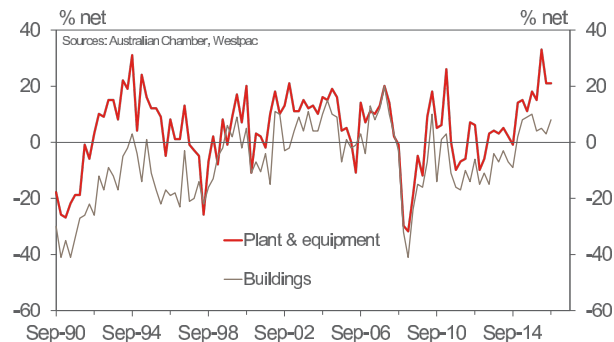
## Profit expectations

	Q2 2016	Q3 2016
Net balance	19	25

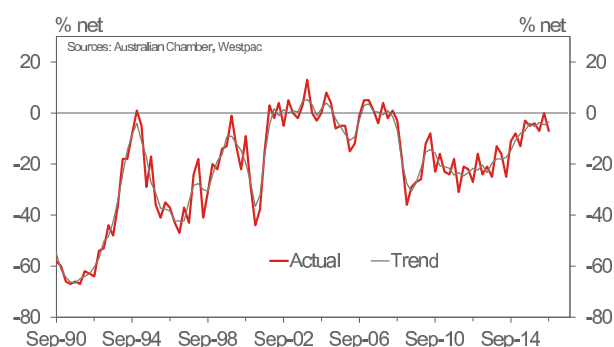
- Firms are looking to 2017 to be another positive year for profits.
- A net 25% of respondents expect profitability to improve in the next twelve months. This is a solid reading, exceeding the long-run average of the series, +19%, and up from 19% in June. However, it is down from the highs reported during 2015.
- Expectations that profitability will improve are consistent with the outlook for output expansion. In addition, selling prices are increasing somewhat. Although, the recent lift in the currency has modestly reduced earlier gains in competitiveness.

## Investment intentions

### Next twelve months

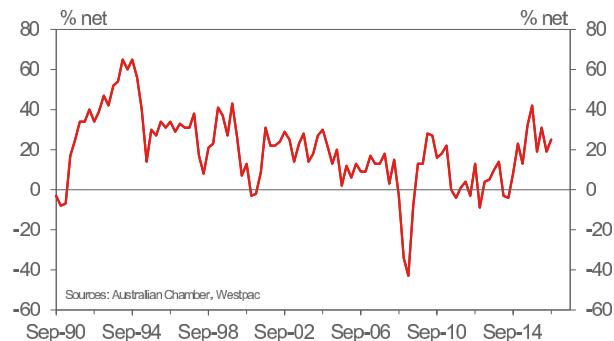


## Capacity utilisation



## Profit expectations

### Next twelve months





# The labour market

## Numbers employed *(seasonally adjusted)*

	Q2 2016	Q3 2016
Actual – net balance	– 1	2
Expected – net balance	2	1

- Manufacturers' views on hiring have strengthened since the middle of last year.
- In September, a net 2% of firms reported expanding their workforce. That follows a consolidation over the first half of 2016 and a turnaround from the declines of 2014.
- Employment intentions also point, at the margin, to rising staffing levels. A net 1% of firms expect to increase their workforce in the coming three months, following a net 2% in June and a net 4% in March.
- The ongoing output expansion evident over the past two years appears to have given manufacturers the confidence to commit to growing their workforce.

## Overtime worked *(seasonally adjusted)*

	Q2 2016	Q3 2016
Actual – net balance	20	36
Expected – net balance	29	21

- Over the past three and a half years, overtime has consistently been used by manufacturers to respond to rising new orders.
- The survey appears to suggest that the use of overtime has been more widespread of late than in the past.
- In September, overtime again played a role. A net 36% of respondents increased overtime in the period, up from 20% in June, a period of more moderate output expansion.
- Expectations moderated somewhat in September, with a net 21% anticipating an increase in overtime in the coming three months, down from a net 29% in June. That said, the September figure is in line with the 2015 average.

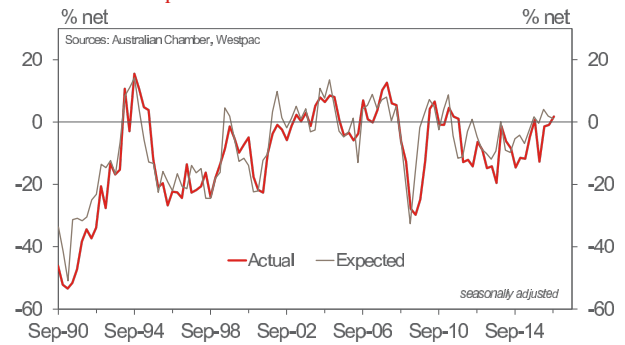
## Difficulty of finding labour *(seasonally adjusted)*

	Q2 2016	Q3 2016
Net balance	6	2

- 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 September quarter, a net +2% of respondents reported labour as harder to find. This partially reverses the tightening of labour market conditions reported in June, when the indicator went from –5% to +6%.
- The official ABS data suggests that labour market conditions have eased somewhat in 2016. The hiring burst of 2015 has given way to a consolidation of late. The unemployment rate has held steady around 5.8% as the participation rate edged lower.

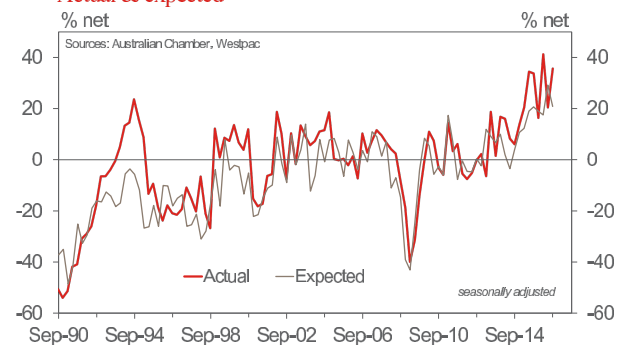
## Numbers employed

### Actual & expected

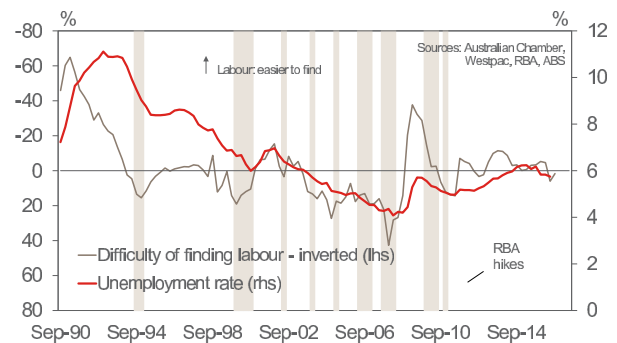


## Overtime worked

### Actual & expected



## Labour market tightness



# Prices & inflation

## Average unit costs

	Q2 2016	Q3 2016
Actual – net balance	21	29
Expected – net balance	12	18

- In 2016, cost escalation appears to have re-emerged as an issue for manufacturers. This follows a period in which cost rises had been a little less marked than is the norm.
- A net 29% of firms reported a rise in unit costs in September, after 21% in June, a step-up from 14% during 2015 and compares to an historic average of 21%.
- The increase in cost pressures is against a backdrop of a bounce in commodity prices, up from historic lows. Prior to this, average cost pressures had been relatively modest despite the sharp fall in the currency, evidence of the lack of domestic inflation pressures, with weak wages growth a key dynamic.

## Average selling prices

	Q2 2016	Q3 2016
Actual – net balance	4	5
Expected – net balance	1	12

- Price rises for manufacturers have been more prevalent since mid-2013, in contrast to the lack of pricing power which is often the norm. In September, a net 5% of firms reported an increase in prices, following a net 4% in June.
- These results are most likely evidence that rising import costs are flowing through the pricing chain, often with a lag. Firms are unlikely to have the scope to fully absorb the impact of the 28% fall in the currency since early 2013, when it was trading above parity to the US dollar.
- Respondents expect prices to increase in the next three months, with a net 12% expecting a rise. Although, historically, there has been a tendency for actual outcomes to fall short of expectations.

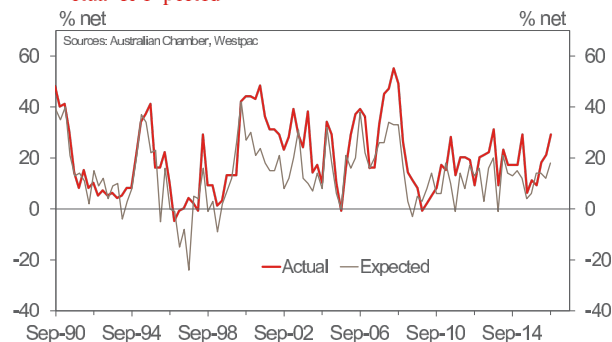
## Manufacturing wages

	Q2 2016	Q3 2016
Net balance	1	8

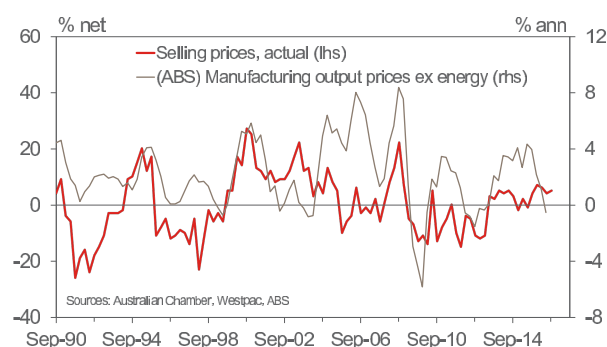
- The survey provides a guide to wage growth prospects for the manufacturing sector, correctly foreshadowing the marked slowing of wages growth evident of late.
- More recently, the survey points to a strengthening in wages growth in the year ahead. In September, a net 8% of firms expect their next wage deal to deliver an outcome above the last.
- To date, the official data continues to report weak wages growth. This has been a key feature of the broader Australian labour market, as well as the manufacturing sector. Significantly, national income has been squeezed by sharp falls in the terms of trade. In 2016, there has been an emerging stabilisation in the terms of trade.

## Average unit costs

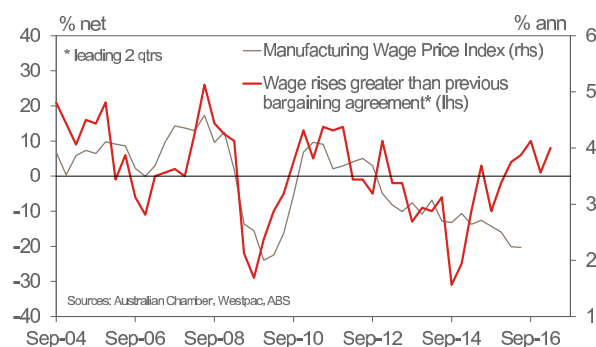
### Actual & expected



## Manufacturing upstream price pressures



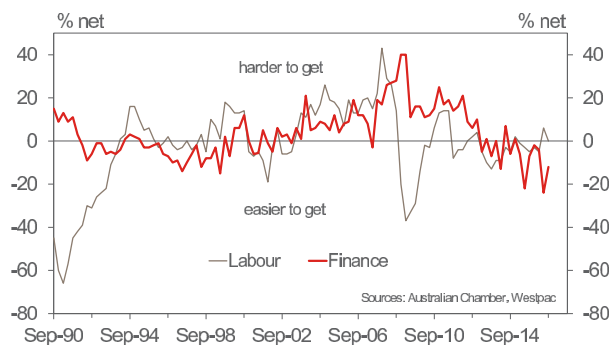
## Manufacturing wage growth



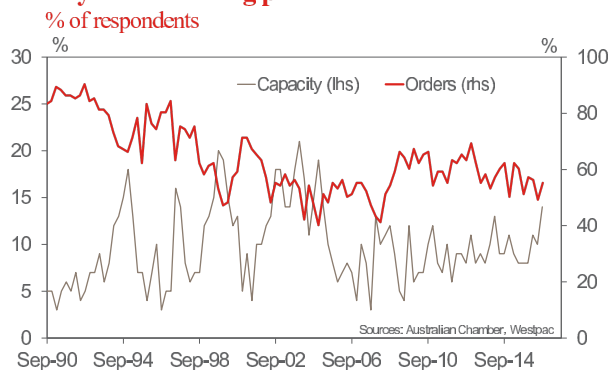


# Other results

## Availability of labour & finance

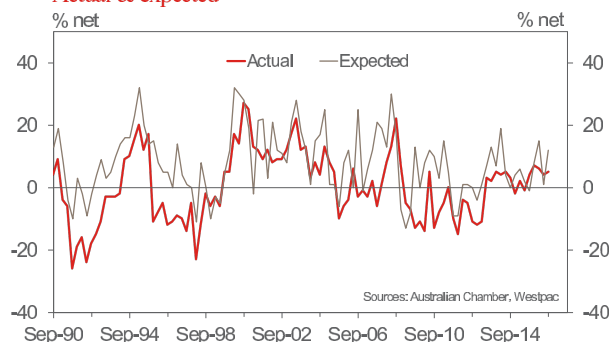


## Key factor limiting production

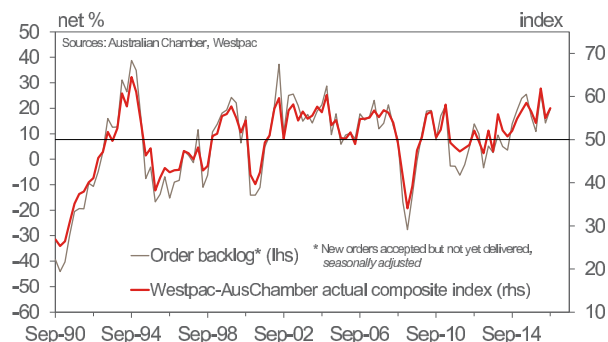


## Average selling prices

Actual & expected

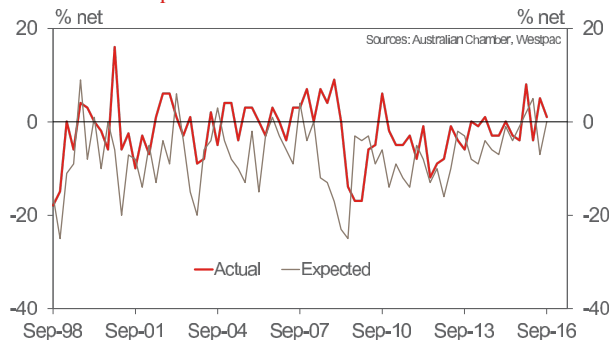


## Order backlog & actual conditions



## Stocks of finished goods

Actual & expected



## Factors limiting production

	Q1 2016	Q2 2016	Q3 2016
Orders (%)	56	49	55
Capacity (%)	11	10	14
Labour (%)	3	2	2
Finance (%)	3	5	4
Materials (%)	1	1	3
Other (%)	19	20	13
None (%)	7	13	9

# Summary of results (not seasonally adjusted)

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
25	32	61	7

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

Net balance	Above Normal	Normal	Below Normal
-7	11	71	18

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

None	9	Orders	55
Material	3	Finance	4
Labour	2	Capacity	14
Other	13		

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?	0	4	92	4
(b) finance?	-12	2	84	14

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?	8	16	74	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	10	81	9	4	12	80	8
7. Overtime worked	28	33	62	5	31	39	53	8
8. All new orders received	17	31	55	14	36	41	54	5
9. Orders accepted but not yet delivered	2	13	77	11	28	30	68	2
10. Output	17	29	59	12	42	47	48	5
11. Average costs per unit of output	29	32	65	3	18	20	78	2
12. Average selling prices	5	9	87	4	12	14	84	2
13. Export deliveries	0	3	94	3	2	3	96	1
14. Stock of raw materials	-7	4	85	11	7	10	87	3
15. Stocks of finished goods	1	9	83	8	0	10	80	10

# Summary of results (not seasonally adjusted)

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

(a) Improve?	33
(b) Remain unchanged?	59
(c) Decline?	8
<b>Net balance</b>	<b>25</b>

**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?	17
(b) Same?	74
(c) Less?	9
<b>Net balance</b>	<b>8</b>

**A.** Industry profile of survey:

	(% of respondents)
Food, beverages, tobacco	13
Textiles, fabrics, floor coverings, felt, canvas, rope	3
Clothing, footwear	6
Wood, wood products, furniture	3
Paper, paper products, printing	10
Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products	14
Non-metallic mineral products: glass, pottery, cement bricks	7
Basic metal products: processing, smelting, refining, pipes & tubes	1
Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools	11
Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs	6
Other machinery & equipment: electrical, industrial scientific, photographic	14
Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery	12

**B.** How many employees are covered by this return?

1-100	101-200	201-1000	Over 1000
52	7	21	20

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

WA	SA	VIC	NSW/ACT	QLD	TAS
11	12	21	39	13	4

## 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%.

## Things you should know.

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

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## Disclaimer continued overleaf

## Disclaimer continued

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