

2009Q2 Westpac-ACCI Survey of Industrial Trends

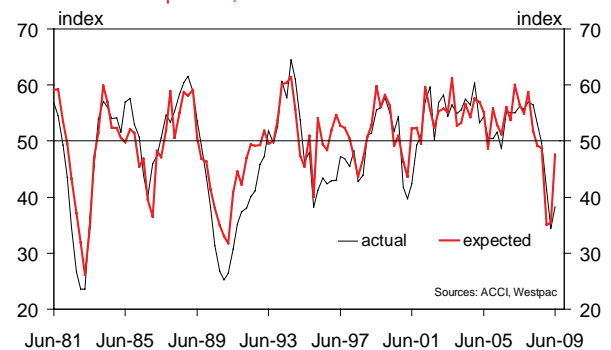
Activity, expectations & confidence improve, but still consistent with contracting activity

- The 191st Westpac-ACCI Survey of Industrial Trends was closed in the week ending 12 June, amidst a backdrop of encouraging 'green shoots' of a global recovery, relative resilience in the Australian economy with significant fiscal policy support, improved housing indicators and a reduction in the perceived difficulty of obtaining finance.
- The Actual Composite Index rose 3.9pts to 38.3, partially reversing a 6.9pt fall previously, but remains well below 50 consistent with contracting activity in 2009Q2. It also remained at a level not consistently seen since the 1990/91 recession, below its decade average (52.3) for the fourth consecutive quarter, and was broadly in line with predictions in the prior survey's Expected Composite Index.
- The less-bleak economic backdrop saw some improvement in expectations, driving the Expected Composite Index 12.3pts higher to 47.6 (highest since 2008Q3). However this level remains consistent with a further (albeit milder) contraction in Q3, below its decade average (52.8). General business sentiment surged 57pts (greatest improvement since 1975) to -4 (highest since 2007Q4).
- Labour demand indicators improved moderately, but remained consistent with a sharp slowing in jobs growth through 2009H2 and a rise in the unemployment rate eventually beyond 8%. The Labour Market Composite net balance rose 8pts to -25, historically consistent with -1½%yr jobs growth. Perceptions of labour market tightness rose slightly but only to their second lowest level since 1992Q1.
- Surprisingly, credit conditions eased, although the proportion seeing finance as a constraint remained at a 34 year high. However, an overwhelming majority continue to rate insufficient orders as the most significant constraint.
- With improved business expectations, investment plans firmed somewhat, but remained historically weak, still consistent with falling investment through the year ahead.
- Selling prices continued to fall and unit cost pressures are easing, but pressure on profit margins remained strong.

After a cumulative 15.3pt fall in the December quarter 2008 and March quarter 2009 surveys, the Westpac-ACCI Actual Composite Index of activity rose 3.9pts in the June quarter 2009 to 38.3 from a revised (due to annual seasonal adjustment reanalysis) 34.5. Still, this left the index well below 50 consistent with a further (albeit slightly milder) contraction in manufacturing activity in the June quarter. Despite this improvement, the Index remained below its decade average (52.3) for the fourth consecutive

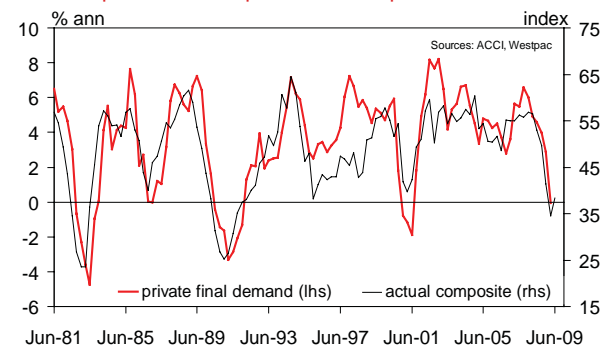
Westpac-ACCI composite indexes

Actual & expected, sa



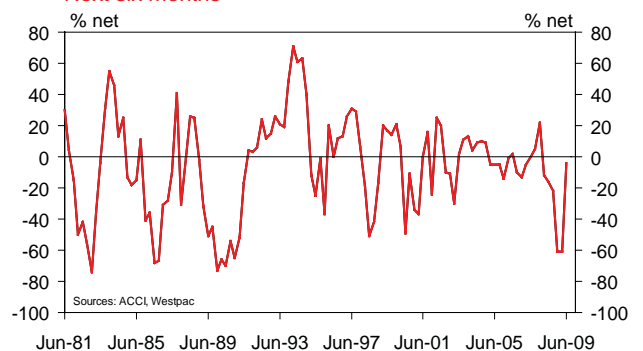
Manufacturing & the business cycle

Westpac-ACCI composite index & private demand



General business situation

Next six months



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quarter. It remains at a level not consistently seen since the 1990/91 recession, although it is well above the troughs reached in the 1990/91 (25.3) and 1982/83 (23.6) recessions. The Actual Composite Index is also on the cusp of levels (37) historically consistent with annual contractions in private final demand growth in 2009Q2, after the Q1 National Accounts showed annual private final demand growth falling to -0.1%. The survey found the rise in the June quarter Actual Composite Index was driven by lesser declines than previously in new orders, output and overtime, partially offset by a slightly steeper employment fall.

An improved performance is hoped for by survey respondents for the September quarter. Improvements beyond the typical seasonal rise were seen in all components, with expectations of a rise in new orders and output, and smaller expected falls in employment, the order backlog and overtime. After seasonal adjustment, this drove a strong 12.3pt jump in the Expected Composite Index to 47.8, the highest since 2008Q3. Still, at sub-50 the Index remains consistent with a further (albeit milder) contraction in Q3, and below its decade average (52.8) for the sixth consecutive quarter.

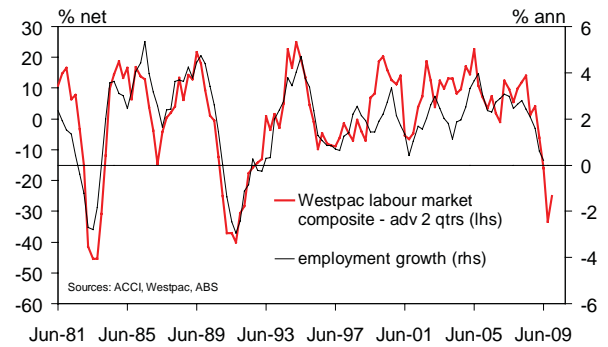
General business confidence saw its largest improvement since 1975, bouncing 57pts to a net -4%, the highest since 2007Q4, encouraged by 'green shoots' of a global recovery, the relative resilience of the Australian economy, improved housing indicators and a perception of easier credit conditions from respondents. Arguably though this improvement in confidence could be exaggerated by the deterioration in actual conditions being a reality in the present rather than a prediction of the future. An expectation of a continuation of current weakness in conditions for the next six months would naturally drive a surge in the proportion expecting conditions to remain the same, and a fall in the proportion looking for further deterioration, and drive an improvement in the net balance even though continued similar weakness in conditions is expected. On this occasion, the proportion expecting conditions to remain the same jumped to 50% from 27%, while the proportion looking for further deterioration fell to 27% from 67%, explaining 40pts of the 57pt bounce in the General business confidence net balance.

The survey showed a moderate improvement in labour demand indicators, but they remained consistent with a sharp slowing in jobs growth through 2009H2 and a rise in the unemployment rate beyond 8%. The Westpac-ACCI Labour Market Composite net balance rose 8pts to -25%, the highest since 2008Q4. It remains well below its decade average (+6%) and the lows of the 2000/01 (-7%) and 1996/97 (-10%) slowdowns, although above the lows of the 1990/91 (-40%) and 1982/83 (-45%) recessions. The rise in the net balance in the June quarter was driven by less negative reads for expected employment and actual and expected overtime, partially offset by a slightly more negative actual employment reading. Despite this less negative June quarter level, it remains consistent with a sharp slowing in jobs growth through 2009H2 to around -1½%yr from the current (May) trend of +0.1%yr. Our current forecasts project a slightly greater deterioration to -2%yr at end-2009, lifting the unemployment rate towards 8% at year end, and beyond in early 2010.

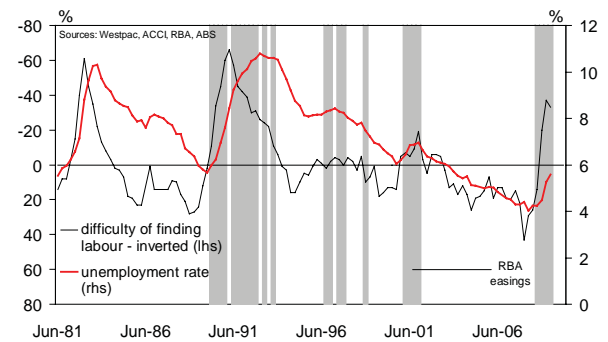
The survey saw a slight rise in perceptions of labour market tightness, but only to their second lowest level since 1992Q1. The net balance of respondents reporting labour as "harder to get" rose to -33% from -37% (vs decade average of +8% net). Still, the net balance remains at levels not seen since the 1990/91 recession, and remains consistent with a rise in the unemployment rate beyond 8% from the current (May) 5.7% level.

With firmer labour demand indicators and a slightly less easy "difficulty of finding labour", manufacturers' wage growth

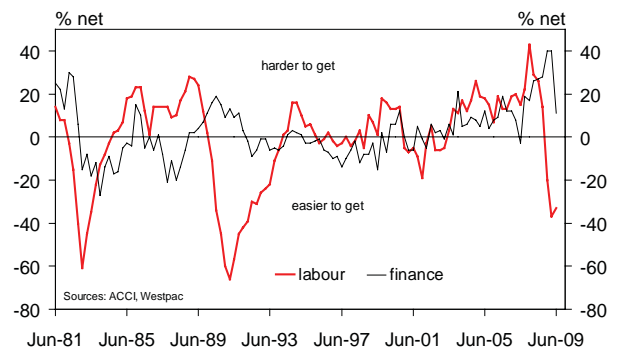
Jobs growth to deteriorate rapidly 2009H2



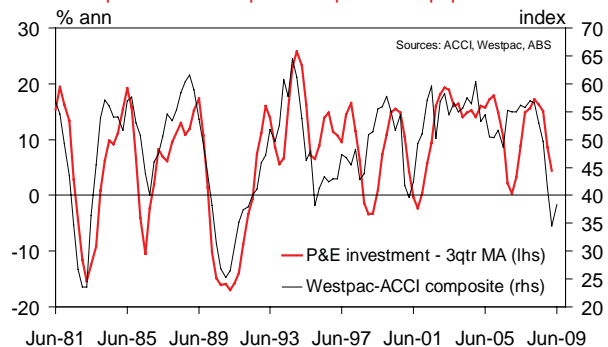
Difficulty of finding labour



Availability of labour & finance



Activity & capital investment Westpac-ACCI composite & plant & equipment investment



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expectations rose moderately in the June quarter. A net balance of -18% (vs -29% previously) of respondents expect wage rises in their firm's next round of enterprise bargaining agreements to be higher than the previous agreement outcome. While up from the previous expectation, this is still the third weakest result on record (data commenced 1997), well below its decade average (+11%). It continues to point to a rapid slowing in manufacturing wage growth through 2009H2 from (using the manufacturing wage price index) 2009Q1's 3.6%yr pace, which itself was down from a peak pace of 4.5%yr in 2007Q3.

Somewhat surprisingly, credit conditions eased in the June quarter with the net balance reporting finance as "harder to get" falling to 11% from a 34 year high of 40% previously (vs decade average of 9%). Despite this improvement, the proportion of respondents nominating finance as the single factor most constraining their ability to increase production was unchanged for the third consecutive quarter at 7% (equal highest since 1974Q4). Still, an overwhelming majority (64%) of respondents continue to rate insufficient orders as the most significant constraint on expansion.

Along with improved business expectations and the bounce in confidence, investment plans firmed somewhat, but remained historically weak. Net capacity utilisation improved to -29% from -36%, but remains well below its decade average (-7%) at its second lowest level since 2001Q2. The Actual Composite Index also has a leading relationship with aggregate economy investment spending on plant and equipment, and despite its latest improvement it remains in the territory (sub-40) associated with falling total plant and equipment investment on an annual basis. Similarly, surveyed twelve month investment plans improved but to still historically weak levels consistent with contracting manufacturing investment spending. The net balance for plant and equipment spending plans rose to -19% from -32% (vs decade average +7%). The net balance for building spending plans rose to -24% from -41% (vs decade average +1%).

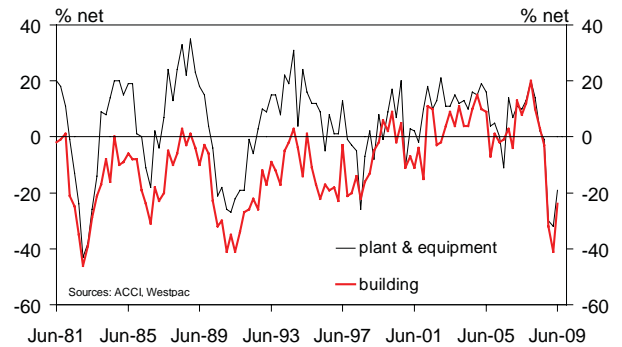
Export deliveries eased further to a net -10% in the June quarter from -8% previously, their weakest since 2001Q1. However, despite the damage to international competitiveness from a higher AUD exchange rate, the dominance of improved global demand indicators has driven a strong recovery in export expectations for the September quarter to +9%, although still sub-par (decade average expectation is +14%).

The June quarter Westpac-ACCI Survey results showed a continued abatement of manufacturing price pressures. The net selling prices indicator fell to -7% from -5%. Although higher than the -13% prior prediction, this was the lowest outcome since 2005Q3 and the first back-to-back net negative readings since 2006Q4 and 2007Q1. September quarter selling price expectations (-8%) project a similar degree of price weakness next quarter, the second weakest price expectation since 1998Q4. Unit cost pressures also continued to gradually ease and are expected to see an outright small decline in Q3. The net balance for actual unit costs eased to 11% from 14%, the lowest degree of cost pressure since 2005Q3. An outright small fall in unit costs is predicted for the September quarter 2009 (net -3%), the first net negative expectation since 1999Q1. However, with unit cost expectations still above selling price expectations, pressure on profit margins remains strong. Twelve month profit expectations improved to a net -8% from -43% previously, reflecting the improved Composite Index and confidence, but remained well below their decade average (+13%) at their equal third weakest level on record (series commenced 1988).

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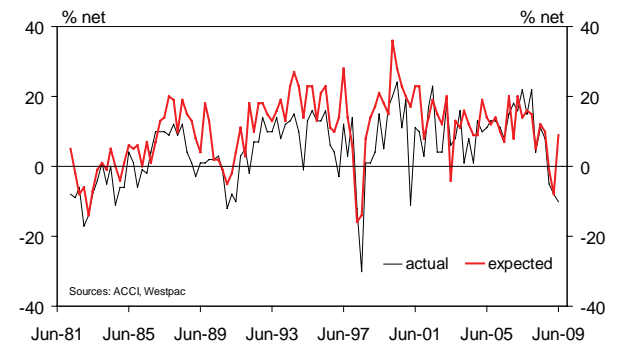
Investment intentions

Next twelve months



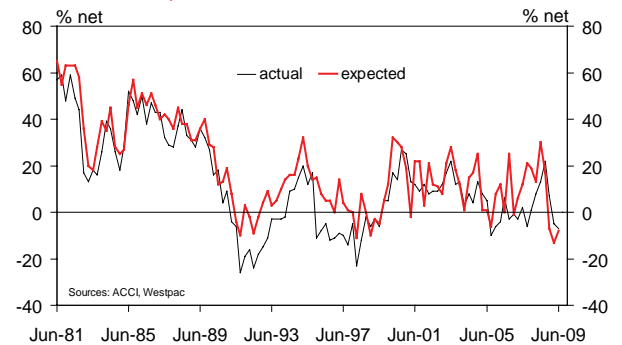
Export deliveries

Actual & expected



Average selling prices

Actual & expected



Average unit costs

Actual & expected

