Embargoed until 11.30 am Tuesday 12 October, 2004

National's Monthly Business Survey – September, 2004

Business Conditions Remain at Very Robust Levels;

Leading To A Sharp Kick Up In Confidence;

Business Hiring, Capital Spending and Capacity Utilisation All Strengthen;

Exports Continue Their Recent Trend Improvement;

Wage Increases Continue in the Face of Tighter Labour Market Conditions;

Prices Also Show More Signs of Accelerating From Recent Lows;

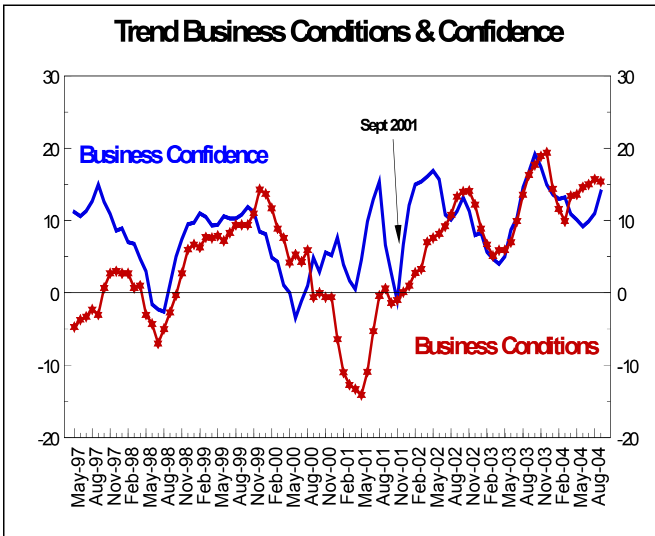
House Price Expectations Steady – Basically Flat Prices Expected;

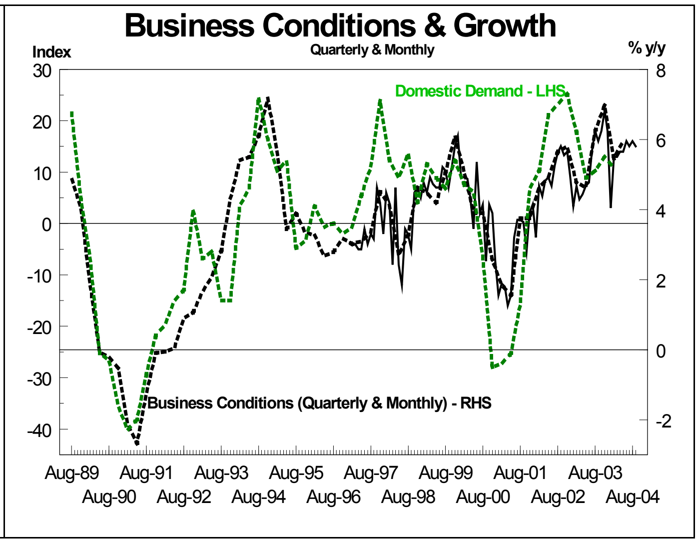
National's Key Forecasts Unchanged; and

We Still See A Cash Rate Rise Pre-Christmas – As Does Business

The key message from the National's September Monthly Survey is that, having rebounded from mid-year, business conditions remained at very robust levels in September. Equally important, however, is that strength in outcomes is now translating into stronger business willingness to both hire and invest. Furthermore, levels of business confidence have bounced up to approach the (near record) levels reported mid to late 2003.

It should, however, be noted that these results do not reflect the Federal Election outcome as the Survey was conducted in the last week of September. Rather, the kick in confidence would appear to reflect the following dynamic: In late 2003, business confidence fell earlier and more sharply than the subsequent slowing in business outcomes. Business, however, continued to regard the outlook with some caution and hence confidence readings tended to be weaker than actual activity levels. That gap, however, has now closed as businesses judge the recent reacceleration of growth as more likely to be sustained – see Chart below. Of course, pre-election spending proposals by both sides of politics may have added to that expectation.

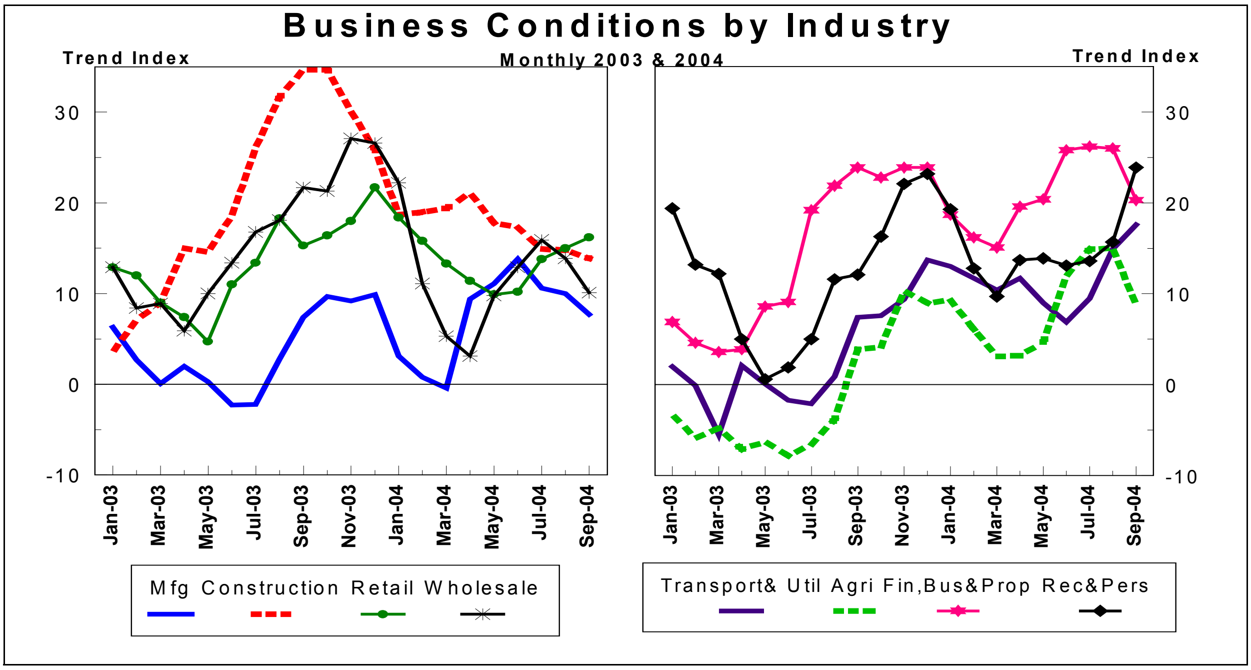




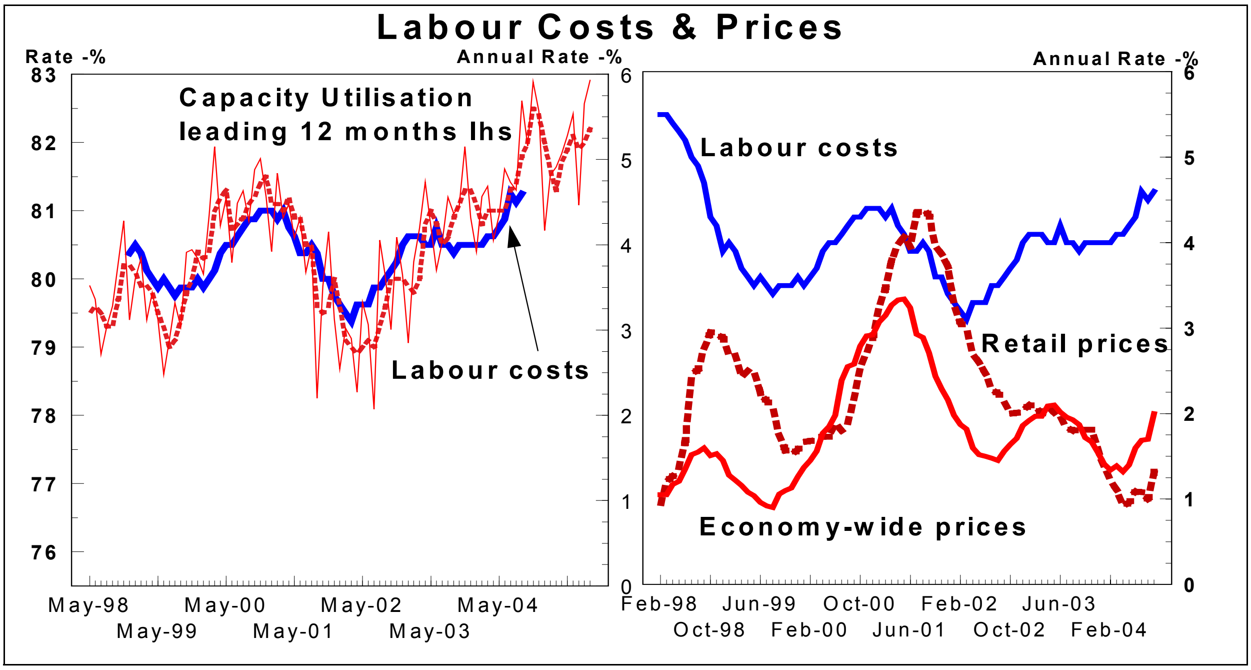
The second panel of the above Chart also highlights just how strong reported business conditions remain – that is, they are consistent with domestic demand continuing to grow at around the 6% per annum mark. As well as

contributing to much stronger levels of business confidence, the September Survey was notable for the reported further strengthening in the measures for employment, business investment and capacity utilisation – while forward orders edged higher from already strong levels. Exports also continued to trend up-wards (reporting a positive balance for the fourth month in a row – the first such run since mid 2001). All of this reinforces expectations of a continuing favourable near-term economic outlook.

Looking at the Survey results by sector/industry, the general trend to more "balance" between external and domestic orientated sectors continued. That said, in September stronger business conditions in retail and the personal & recreational services sector were offset by some weakening in wholesale and property services. The differing trends in business conditions for the wholesale and retail sectors also were associated with falling forward orders in the wholesale sector and increased stocks in the retail sector. That is, it could well be that we are seeing a fundamental weakening in the near-term prospects for the retail sector – albeit retail confidence remains high. Beyond that, construction sector activity continued its recent moderate softening trend. The following Chart shows the movement in trend business conditions across the key industry groups.



Turning to inflation, both wage and price pressures have increased in recent months. In particular, there continues to be a gradual drift up in wage pressures in the face of high levels of capacity utilisation and reported difficulties in obtaining new labour. Over the past year, wages as measured in the monthly Survey, have increased by 4.6% – and, as illustrated in the Chart below, could be expected to climb further over the next 6 months or so. Price increases also appear to reflect fundamental influences – with economy wide prices now up by 2% over the past year. More significantly, there was a noticeable kick up in both the monthly (indeed the largest increase since April 2001) and annual rate of increase in retail prices in September. While still at relatively low levels, retail prices have clearly accelerated from their recent lows – see Chart below.



On the economic outlook, while we will put out a full review of our forecasts with the National's September Quarter Business Survey (due for release on 26 October), we basically do not expect to change either our global or local forecasts. We still see recovery in the global economy continuing, with the US economy in particular expanding by around 4½% in 2004, slowing to around 3¾% in 2005. US inflationary pressures, which had been mounting earlier this year, have abated and we see continued moderate inflationary pressures ahead in 2005. We expect the Fed to continue its policy of gradual interest rate increases back toward a more "neutral" level (with the Fed Funds reaching 3¾% at end 2005).

Locally, we still see Australian GDP growth of around 3¾% in 2004/05 – and marginally higher in calendar 2005. On interest rates, continuing domestic and global strength still, in our view, point to the need for a tighter monetary policy stance. The results from the September Survey further underline that outlook – both on the wage/price outlook and in reinforcing our view that some recent weakness in official data reflected "data volatility" issues, rather than fundamentals. At this stage, we expect a 25 basis point increase in the official cash rate in December 2004 – thereafter, we expect the RBA to be on hold with risks relatively evenly balanced (albeit, we would not rule out the possibility of another 25 basis point increase in early/mid 2005).

Turning in more detail to the Survey, the key results for September were:

- Business conditions were broadly unchanged in September – decreasing by 1 index point to an overall reading of +15 – a reading consistent with ongoing growth in domestic demand of around 6%;
- Within the overall business conditions index, trading conditions eased somewhat, profitability was unchanged and employment strengthened. In more detail, trading conditions fell 4 index points to an overall reading of +20 index points – mainly reflecting a significantly lower reading in the wholesale, and finance property & business services sectors. The profitability index was unchanged at +14 points, while the employment index rose 2 points to +11 index points (with most sectors reporting small rises);
- At the sector level, all industries reported strong business conditions. That said, weaker conditions (relative to last month's) were reported in the wholesale, agribusiness and finance property & business services

sectors. Stronger conditions were reported by the retail sector and personal & recreational services sectors (ie tourism) Construction was moderately lower;

- Forward orders increased by 2 index points to a strong +9 index point reading – surprisingly stronger orders in construction were broadly offset by weaker orders in the retail sector. With offsetting movements tending to cancel out movements in total service sector orders, most other sectors saw small increases. Stocks increased by 4 points to a relatively higher reading of +11 – mainly due to a build up in retail stocks;
- Capital expenditure increased from already strong levels by 3 points to +19 index points. Capacity utilisation levels also increased sharply to 82.9% (82.5% previously). This level of capacity utilisation equals the previous record level of utilisation reported in late 2003;
- Export sales declined 1 point to an overall index of +5 – the fourth month in a row of positive export readings (a run not equalled since mid 2001). As such, this reading suggests a more balanced mix of growth going forward;
- Wage costs increased at a quarterly rate of 1.4% – significantly up on last month's seasonally low reading of 0.8%. Over the 12 months to September, wage costs rose by 4.6% – with the strongest increases reported in the construction and service sectors;
- Overall prices increased by 1.0% in September (at a quarterly rate) – the largest increase since April 2001. This saw economy wide prices rise to 2.0% in the 12 months to September – significantly up on recent lows. Across sectors, one of the largest increases was reported in the retail sector – up 1.4% in the month (at a quarterly rate), significantly boosting the annual rate of retail price increases to 1.3%;
- Purchase costs also increased at a relatively strong 0.9% rate – albeit not as strong as last month's 1.6%. Purchase prices have now increased by 2.7% over the past year – with the more recent strength partly reflecting the higher price of oil and currency effects; and
- Finally, business confidence jumped a very strong 10 index points to an overall reading of +19 index points – that re-approaches the recent highs in business confidence reported around September last year. All sectors reported significant rises in confidence – with the exception of mining, which declined marginally from already very strong levels. Particularly strong improvements in confidence were reported in retail, manufacturing, agribusiness and the recreational & personal service sectors.

For more information contact:

Alan Oster

Chief Economist

03 8641 3464

Embargoed until 11.30 am Tuesday 12 October, 2004

National

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8641 3464
Jeff Oughton	Senior Economist - Australia	+(61 3) 8641 3469
Tom Taylor	Senior Economist - International	+(61 3) 8641 3475
Robert De Iure	Economist - Country Risk	+(61 3) 8641 3445
Carolyn Fraser	Economist - International	+(61 3) 8641 3694
Kyran Curry	Economist - International	+(61 3) 8641 3848
Dean Pearson	Senior Economist - Industry & Commodities	+(61 3) 8641 3474
Antony Clarke	Economist - Minerals & Energy, Manufacturing	+(61 3) 8641 3984
John Sharma	Economist - Property, Business Services, TMTs	+(61 3) 8641 3473
Ian Gordon	Economist - Transport, Healthcare, Retailing	+(61 3) 8641 3472
Luke Chandler	Economist – Agribusiness	+(613) 8641 3442
Tony Pearson	Head of Market Economics	+(61 2) 9237 1180
Spiros Papadopoulos	Senior Economist - Treasury	+(61 3) 8641 0978
Richard Grace	Senior Economist - Treasury	+(61 2) 9237 1180
Kristina Jawerth	Economist - Treasury	+(61 2) 9237 1180

New Zealand

Tony Alexander	Chief Economist – BNZ	+(64 4)474 6744
Stephen Toplis	Head of Market Economics - BNZ	+(64 4) 474 6905
Craig Ebert	Market Economist	+(64 4) 474 6799
Dean Ford	Market Economist	+(64 4)474 6923

London

Tim Fox	Head of Market Strategy – Europe	+(44 20) 7710 2188
Tom Vosa	Head of Market Economics - Europe	+(44 20) 7710 1573
Kris Bernie	Market Economist	+(4420) 7710 2910

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

National