

NAB Quarterly SME Survey

by NAB Group Economics

Embargoed until:
11:30am Thursday 11 February 2016

Dec quarter 2015



Key Points:

- **The NAB Quarterly SME Survey is the leading business survey on small businesses in Australia.** It offers a rich repertoire of insights into factors affecting these firms' conditions by state, industry and size, as well as an assessment on their outlook for investment and output.
- **SME business conditions fell marginally to +3 index points in Q4 from +4 index points in Q3.** Within the components of business conditions, trading conditions were strongest, while profitability remained positive as well. However, employment conditions still lacked momentum. Conditions also continued to vary across business size with "low-tier" firms facing the most challenging conditions.
- **Meanwhile, SME business confidence regained some of its loss in Q3 to be at +3 index points, a level which is slightly above the long-run average of +2 index points.** That said, SME confidence has been on a general slowing trend since late 2013. It is also worth noting that the survey was conducted prior to the recent rout in global financial and commodity markets, which may act to erode confidence.
- **The majority of SME industries experienced lower business conditions in the quarter, but in level terms business conditions in most industries remained positive.** Finance firms continued to outperform other industries, while retail, wholesale and transportation SMEs were the weakest. Business conditions have trended higher in manufacturing in recent quarters (see Industry Focus, P5, for further detail). **SME business conditions were mostly weaker across states as well. However, NSW and VIC conditions were still resilient overall,** while the mining/partly-mining states of QLD, WA and SA continued to be mired in negative territory. Most states' confidence improved in the quarter, except for WA's which sank further into negative territory to reach the lowest level since the GFC .
- **Capacity utilisation fell marginally in Q4.** Similarly, capex by firms has also lost further momentum in the quarter. However, the still-positive readings of the capex and forward orders indices indicate that SME firms continue to operate in an expansionary mode on balance.

	2014	2015	2015
	Q4	Q3	Q4
Business Conditions	2	4	3
Low-tier firms	-5	0	-6
Mid-tier firms	3	4	1
High-tier firms	5	6	8
Business Confidence	2	-2	3
Low-tier firms	-3	-2	1
Mid-tier firms	2	2	6
High-tier firms	4	-4	2
Trading Conditions	8	13	9
Low-tier firms	-1	4	-1
Mid-tier firms	7	11	10
High-tier firms	13	18	14
Profitability	1	3	2
Low-tier firms	-4	-1	-11
Mid-tier firms	2	4	-1
High-tier firms	3	3	9
Employment	-2	-3	-2
Low-tier firms	-8	-2	-5
Mid-tier firms	1	-4	-3
High-tier firms	-1	-4	1

Note*: Low-tier : turnover \$2-3m p.a. Mid-tier: turnover \$3-5m p.a. High-tier: turnover \$5-10m p.a.

Table 1: Business conditions & confidence – Dec qtr

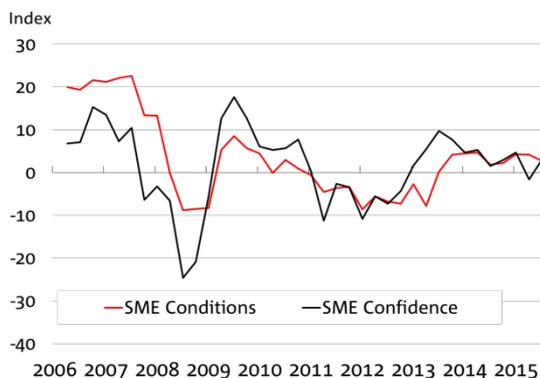


Table 2: Conditions and confidence by industry (net balance, s.a.) – Dec qtr

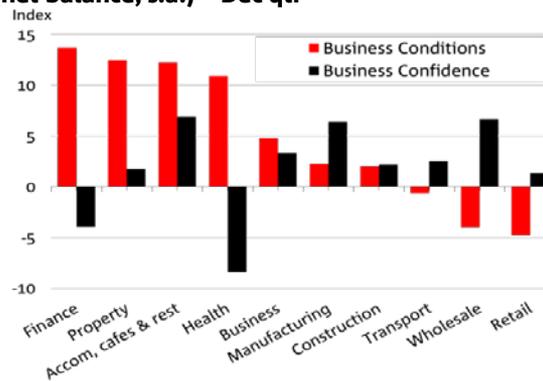
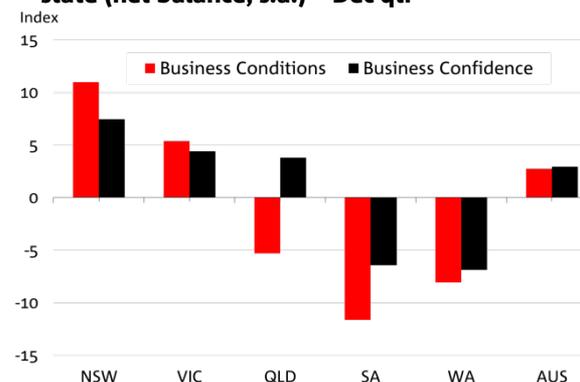


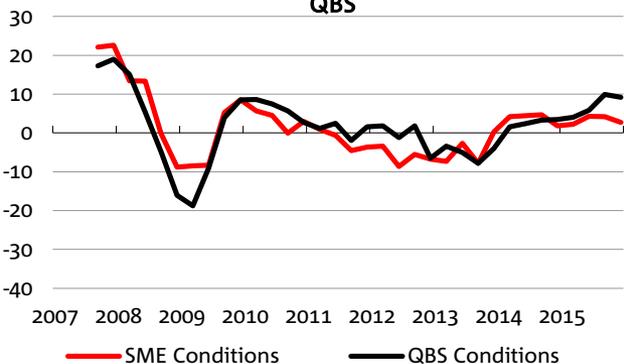
Table 3: Q3 Conditions and confidence by state (net balance, s.a.) – Dec qtr



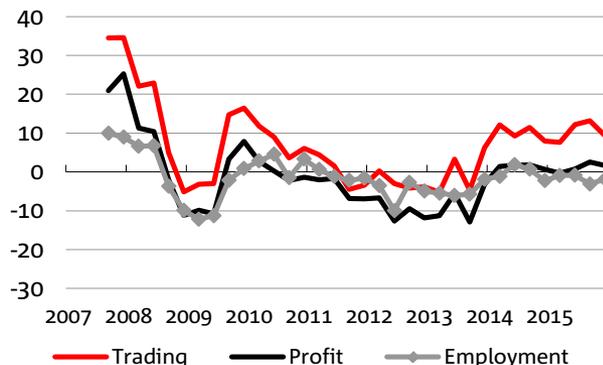
The disparity in SME conditions between high and low-tier firms widens

- **Business conditions for SMEs fell slightly to +3 index points in the December quarter from +4 index points in the September quarter. Business confidence, however, reversed its loss last quarter to be back in positive territory at +2 index points.** SME conditions diverged further from those of general businesses indicated by NAB Quarterly Business Survey (QBS) in the quarter, driven by the much weaker conditions of low-tier SMEs. This is particularly the case for SMEs in retail and wholesale, suggesting that they may not as well-positioned as the larger businesses to maximise the benefits/tackle the challenges arising from changes in the currency. SMEs in manufacturing, however, are experiencing more positive business conditions (see Industry Focus on P5).
- **Despite recording a 4-point fall in the quarter to +9 index points, SME trading conditions have generally held up quite well since early 2014 to average around +10 index points. The profitability index was positive in most quarters over the period as well, albeit at a lower level – a possible reflection of weak margins.** That said, employment conditions remained subdued, to be slightly at odds with official ABS data which showed strong employment growth.
- **Overall, the survey results point to a broadening non-mining sector recovery into late 2015.** Business conditions remain strongest in services industries, with the finance sector (at +14 index points) continuing to outperform other industries. Accommodations/cafes/restaurants tied with property services in second spot at +12 index points. **Meanwhile, retail, wholesale and transportation sectors were the only ones with negative readings in the quarter. For retail and wholesale, higher import costs associated with a lower AUD could be contributing. By state, the two largest states of NSW and VIC continued to outperform at +11 and +5 index points respectively.** SA business conditions weakened further this quarter to -12, while mining states of WA and Qld remained mired in negative territory at -8 and -5 index points respectively. The widening disparity between the best-performing and worst-performing states suggests that the rebalancing of growth away from mining states to non-mining states is gaining traction. Business confidence in most states improved in the quarter, except for WA's which sank further into negative territory to reach the lowest level since the GFC.
- By industry, business confidence mostly improved in the quarter, with the majority reporting positive results. Accommodations/cafes/restaurants and wholesale were the most confident at +7 index points, while health confidence fell 10 points to be the weakest at -8 index points.
- **Compared to the larger businesses in the QBS, SME business conditions were lower in all industries except for manufacturing.**
- **Analysis by the size of firms shows that low-tier SME firms with \$2 to 3 million annual revenue continued to report significantly weaker conditions compared to their larger counterparts. Incidentally they also reported the weakest confidence in the quarter.**

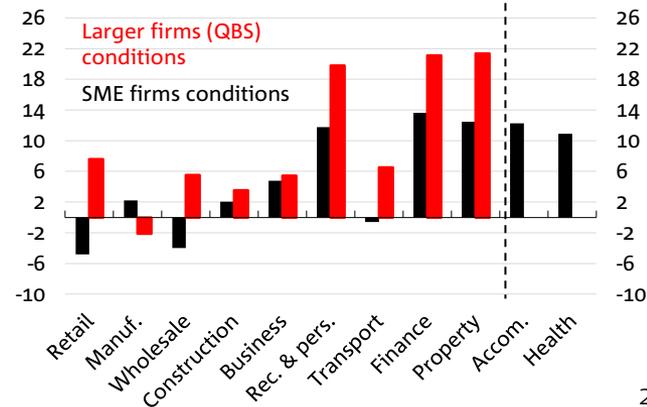
Business Conditions (net bal, sa.), SME & QBS



SME Business Conditions Components (net bal, sa.)



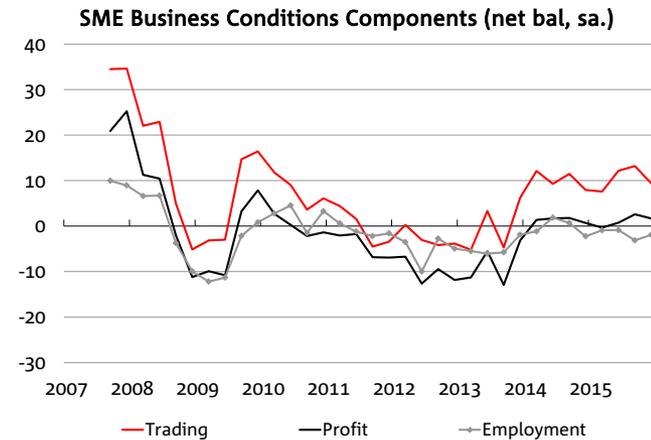
Business Conditions (latest quarter, sa.)



Forward and financial indicators moderated in Q4

- In the December quarter, SME forward orders fell marginally by 1 point to +3 index points, to be still higher than the long-run average of -2 index points. This was broadly consistent with the result for general businesses as reported in the QBS. The SME forward index has largely tracked sideways since early 2014, with little evidence of a significantly lower AUD providing much impetus.
- The generally positive readings for forward orders since early last year are consistent with a moderate recovery in real economic activity.
- Property services, which reported the strongest orders across industries in Q3, experienced a sharp decline of 11 points in its forward orders index to +1 index point in Q4. Seeing through the quarterly volatility, the data suggests that the overall trend in property services' forward orders is a slowing one, consistent with cooling housing market activity nationally. As a sign of improving conditions in the manufacturing sector, forward orders for the sector maintained at around the 6-year high level at +9 index points in the quarter. Meanwhile, a continuous slowdown in engineering and dwelling construction activity was reflected in the lacklustre reading for the construction sector (+2), a long way below its recent peak of +14 in mid-2014. Retail (at -6), health (at -1) and transportation (at 0) reported the weakest forward orders in the quarter.
- The SME stock index remained largely unchanged in the quarter at +2 index points, a level consistent with a moderate pick-up in underlying demand and slightly below that in the QBS. By industry, manufacturing (+7) and wholesale (+6) continued to report the highest levels of stocks. Meanwhile stocks were the lowest in accommodations, cafes and restaurants (-9) while the construction stock index relapsed into negative territory after barely nudging into positive territory last quarter. Overall, at their current levels, the forward and financial indicators point to a moderate but tentative pick-up in activity in coming months.

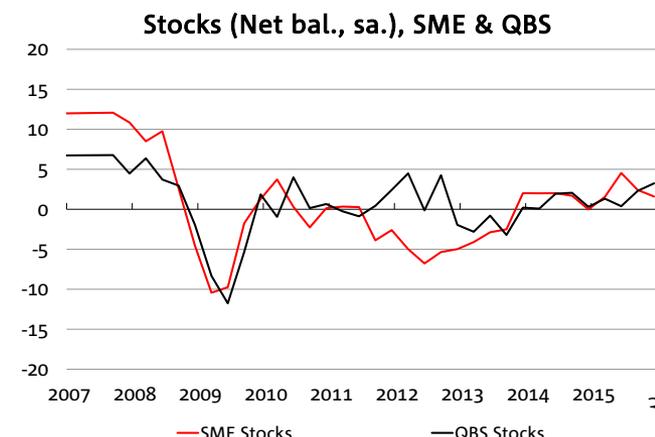
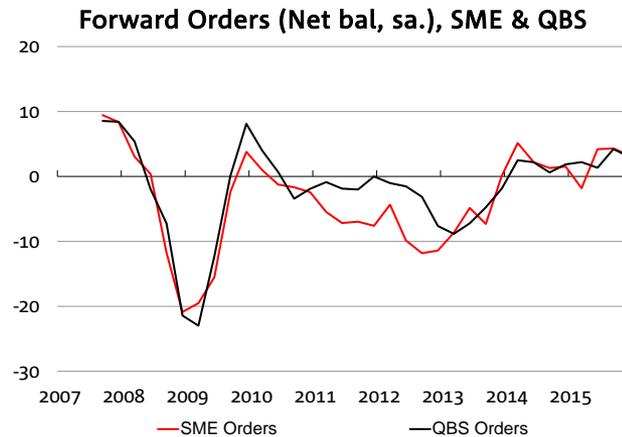
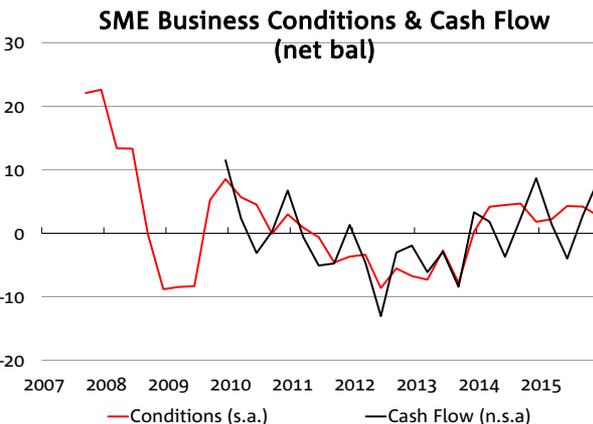
Trading conditions continued to be the key driver for overall conditions, but profitability stayed positive as well



Cash flow rebounded back into positive territory

SME forward orders lost some momentum in Q4

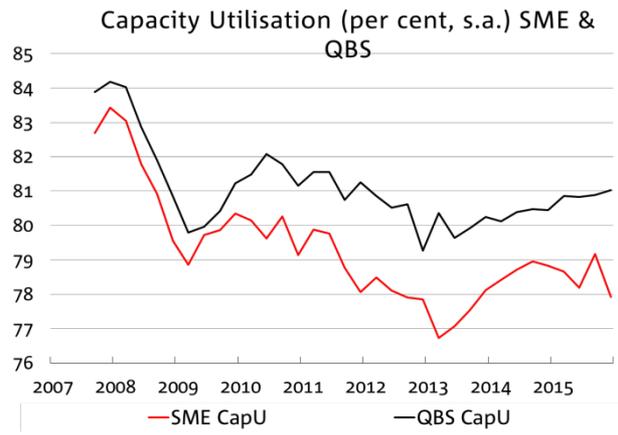
SME stock index slipped below that of QBS



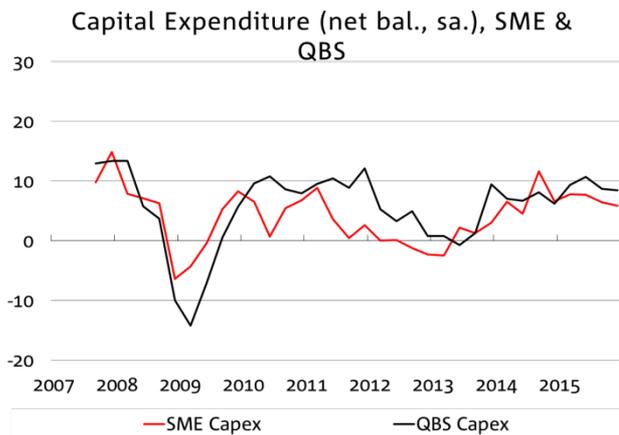
SME capacity utilisation fell marginally in the quarter

- **SME capacity utilisation deteriorated in the December quarter by 1ppt to 78%, consistent with a decline in business conditions and remained below those of general businesses indicated by the QBS.** Services industries continued to report higher capacity utilisation rates in general, with health ranked top at 84.2%, but this level was significantly below its recent peak of 88.2% achieved in Q1 2015. This was followed by business services and property services at 83.5% and 81.4% respectively. Meanwhile manufacturing continued to report the weakest capacity utilisation out of all industries at 73.4% . Despite improving business conditions, manufacturing capacity utilisation has failed to gain substantial momentum over the past two years.
- **Analysis by the size of firms suggests that SMEs of all sizes experienced a fall in capacity utilisation in the quarter, driven largely by mid-tier and low-tier firms, which recorded declines of 1.8ppts and 0.6ppt to 78.1% and 77.1% respectively.** Meanwhile the capacity utilisation rate of high-tier SME firms was more resilient to be at 78.5%, down from 78.8% in Q3.
- **Capital expenditure (capex) by SMEs lost further momentum in the December quarter to stay below the capex reading for larger businesses as indicated by the QBS.** Since peaking in Q3 2014, SME capex has been trending downwards. However, positive readings for both the SMEs and QBS capital expenditure indices indicate that firms continue to operate in an expansionary mode on balance.
- The capex series of individual industries show a high level of volatility from quarter to quarter. This is demonstrated by a 24-point increase in the capex index of transportation to +24 index points to be the strongest performing sector in the quarter. Meanwhile health, which was the best performer last quarter, experienced a 23-point decline to +4 index points over the same time. At -2 index points, construction had the lowest capex reading out of all industries. Aggregate longer-term capex intentions improved, with 12-month capex expectations picking up to +15 in the quarter from +14 the same quarter last year.

SME capacity utilisation reversed the gains in Q3



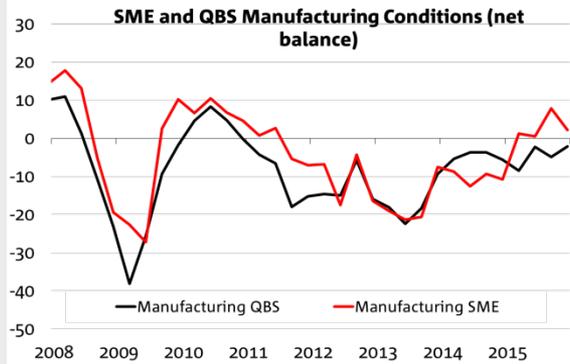
Capex points to moderate expansion in near-term activity



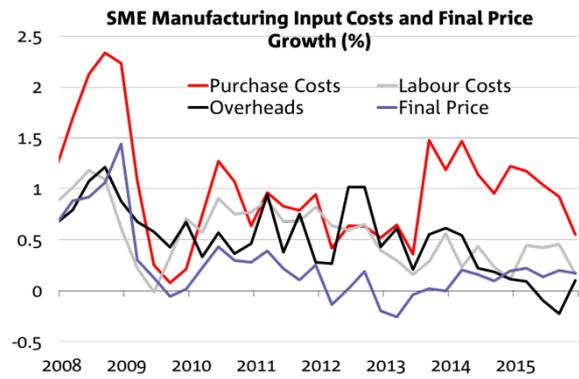
Industry Focus : Manufacturing

- A strong appreciation in the AUD between 2010 and 2013 placed a disproportionate amount of pressure on manufacturing firms in Australia through the erosion of international competitiveness, despite lowering their import costs at the same time. Along with the steady devaluations in the currency since 2013, business conditions experienced by manufacturing firms started to recover gradually, with manufacturing SMEs breaching into positive territory in early 2015.
- While smaller firms tend to experience certain size-specific challenges relative to their larger industry counterparts, this does not seem to be the case for manufacturing SMEs. **In 2015, business conditions for manufacturing SMEs have outperformed general manufacturing businesses indicated by the QBS.** This may be because smaller manufacturers often operate in niche markets where they may not be competing as heavily on price or because their business model is more nimble in terms of responding to specific customer needs.
- While a lower AUD has improved the external competitiveness of manufacturing SMEs, it has also driven purchase cost growth higher in the past two years (see chart at top right hand corner). However, purchase cost inflation has moderated significantly since its peak in 2014, while other sources of cost growth remain relatively well-contained. A moderating trend in overheads growth suggests that manufacturing firms have been undertaking steady cost-cutting to counter higher purchase costs. As such, the cost environment facing manufacturing SMEs has become more benign of late, which appears to have bolstered their trading and cash flow conditions. That said, profitability is more subdued, possibly reflecting weak margins given subdued final product price growth.
- **Forward-looking indicators for manufacturing SMEs such as forward orders and stocks have also been improving.** Somewhat surprisingly, however, this has not translated into higher capacity utilisation, which has been tracking sideways at a low level over the past two years. This suggests that manufacturing SMEs continue to face a challenging demand environment.

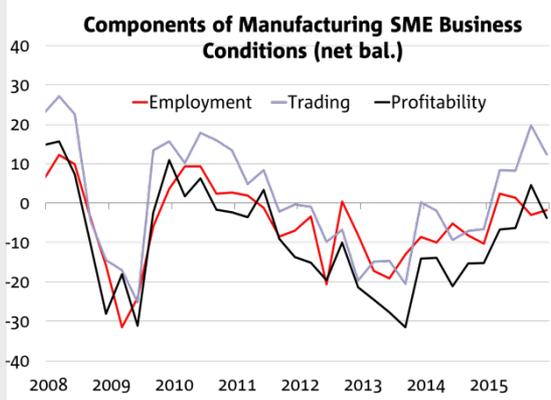
Manufacturing SMEs are outperforming their larger industry counterparts



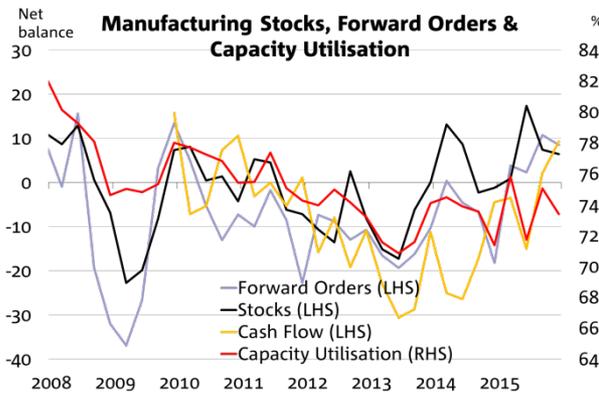
Input costs for manufacturing SMEs are decelerating, but final product inflation is subdued



Trading conditions have improved markedly, but employment and profitability remain subdued



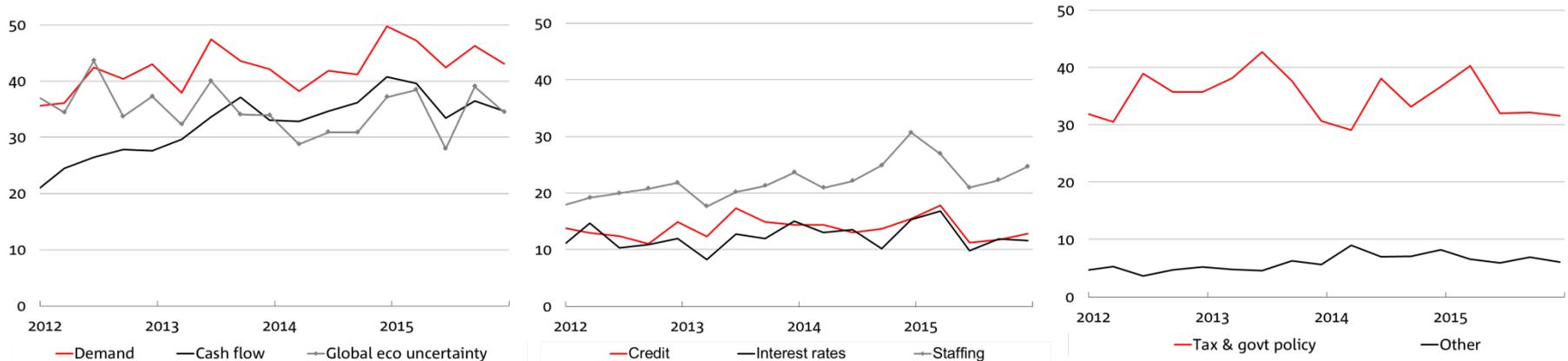
A recovery in forward orders and stocks conditions has not translated into higher capacity utilisation



Significant constraints affecting SMEs' long-term decisions lifted in the quarter

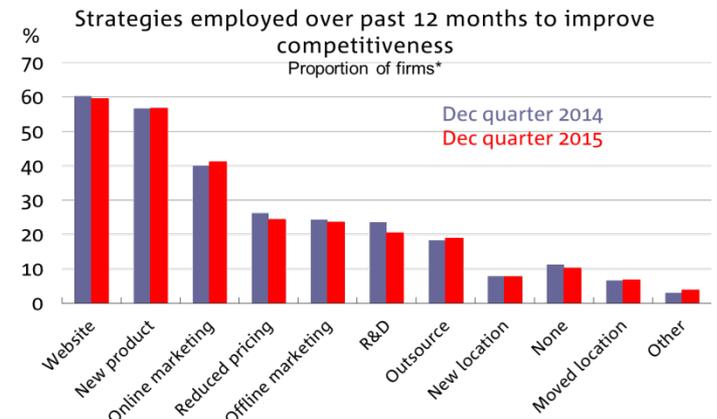
- Easing global volatility and risk aversion in Q4 from their height in Q3 was demonstrated by the amelioration in most of the constraining factors affecting SMEs' long-term decisions in the quarter. It is worth noting that the survey was polled prior to the recent rout in global financial and commodity markets, which may act to erode business and investor confidence.
- Given the above, SMEs reported an improvement in most of the significant constraints affecting their long-term decisions, except for credit and staffing availability. Even so, supply-side factors, including credit, staffing availability, as well as interest rates, continued to be relatively benign overall. Despite a fall in the quarter, demand conditions were still regarded as the most constraining factor at +43 index points.

Most significant constraining factors for SMEs (per cent, multiple responses)



Pattern in SMEs' business strategies is largely stable

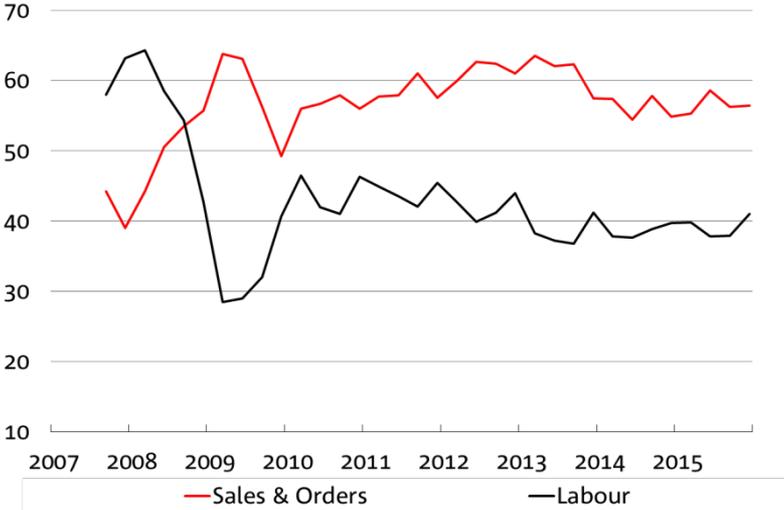
- In the December quarter, we again asked firms whether they had employed any new strategies over the past 12 months to improve their competitiveness in the market.
- There were no significant changes in their strategies in the quarter compared to the same quarter in the previous year, but the results perhaps showed a lesser use of more resource-intensive (and costly) strategies such as R&D and offline marketing, with a preference for strategies such as online marketing. Part of this could reflect the relatively weak investment appetite of SME firms still, despite generally benign business conditions.



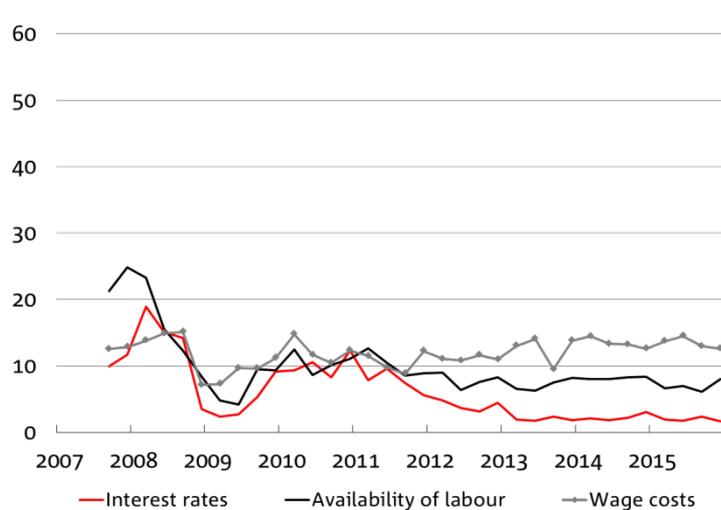
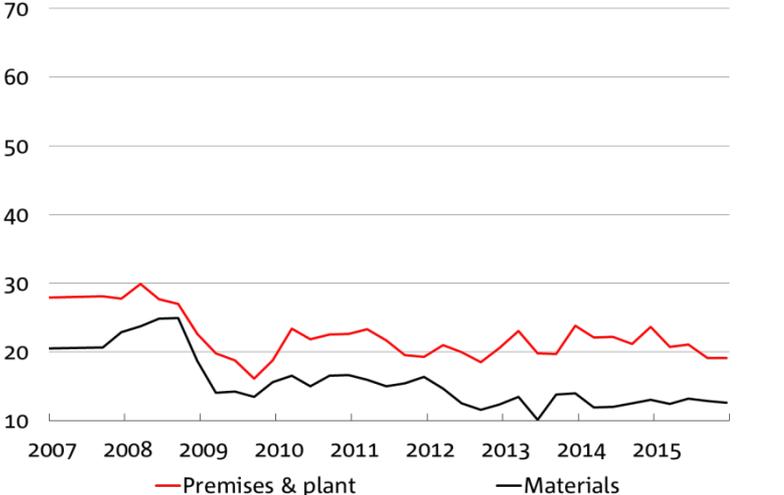
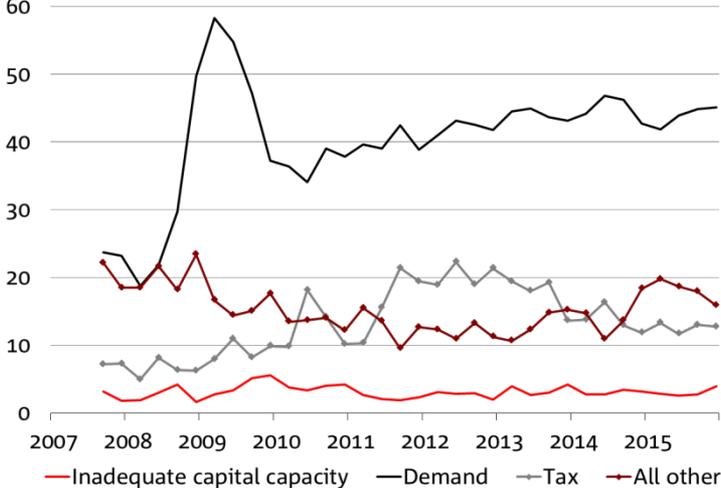
* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

Constraints facing SMEs' output and profitability

Constraint on output (% of firms)

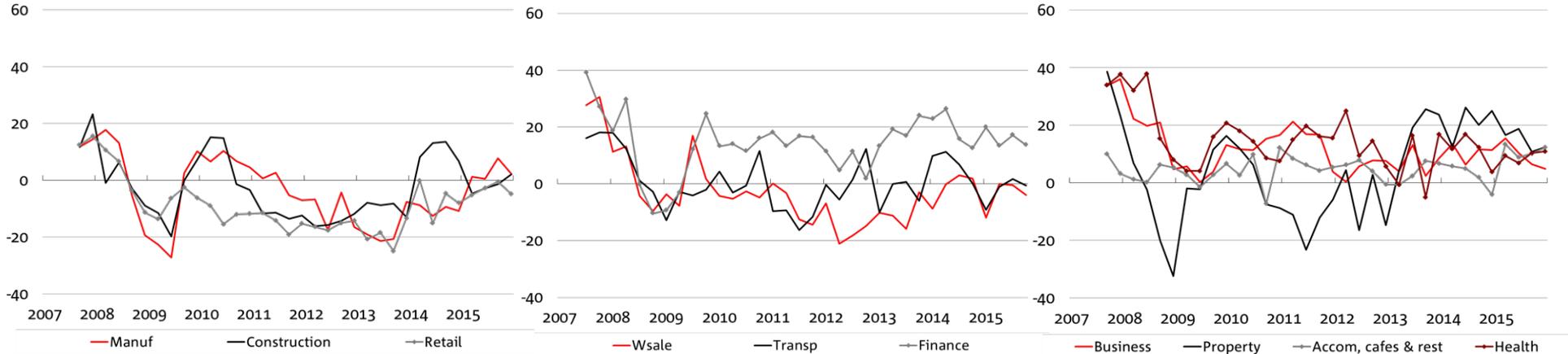


Constraint on profitability (% of firms)

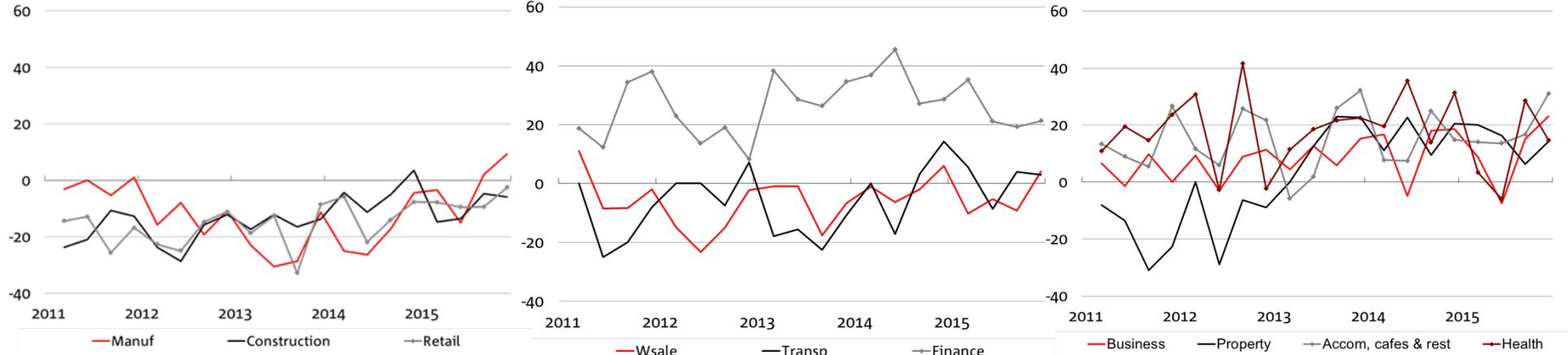


Detail by industry

Business conditions by industry (net balance)

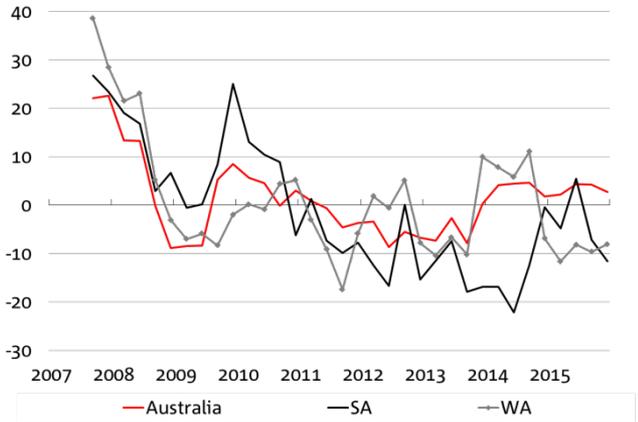
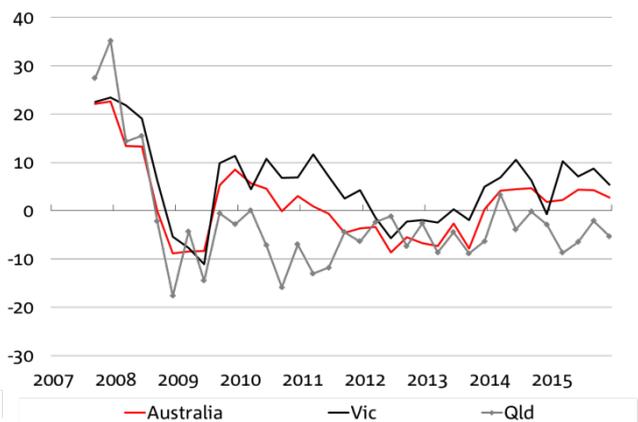
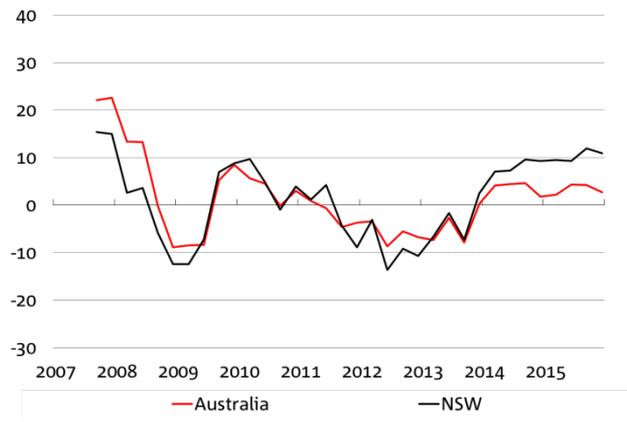


Business confidence by industry (net balance)

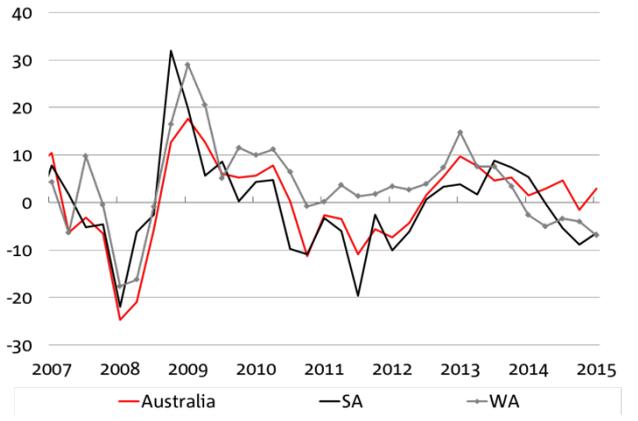
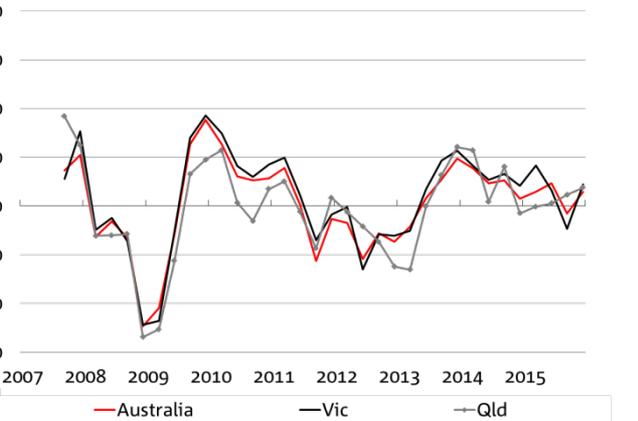
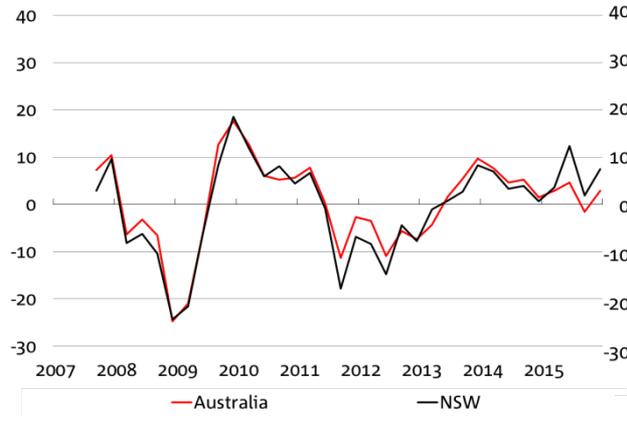


Detail by state

Business conditions by state (net balance)

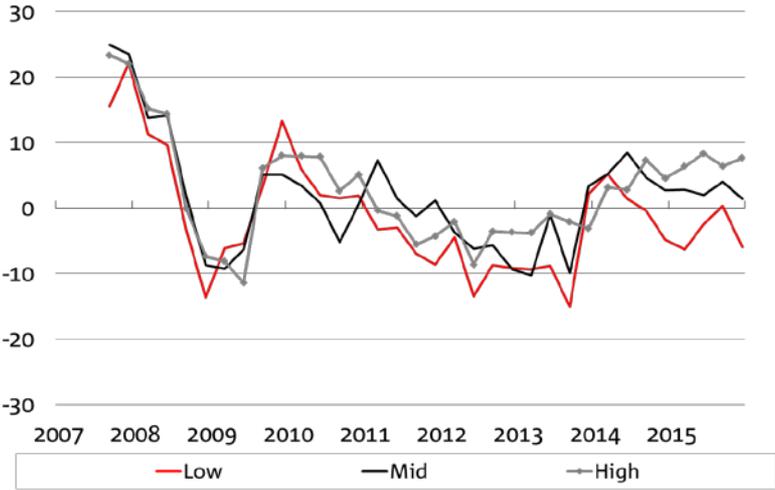


Business confidence by state (net balance)

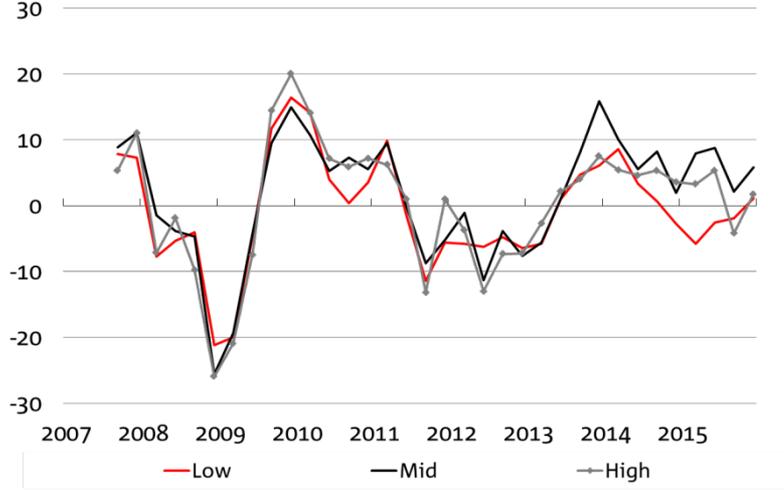


Detail by SME firm size

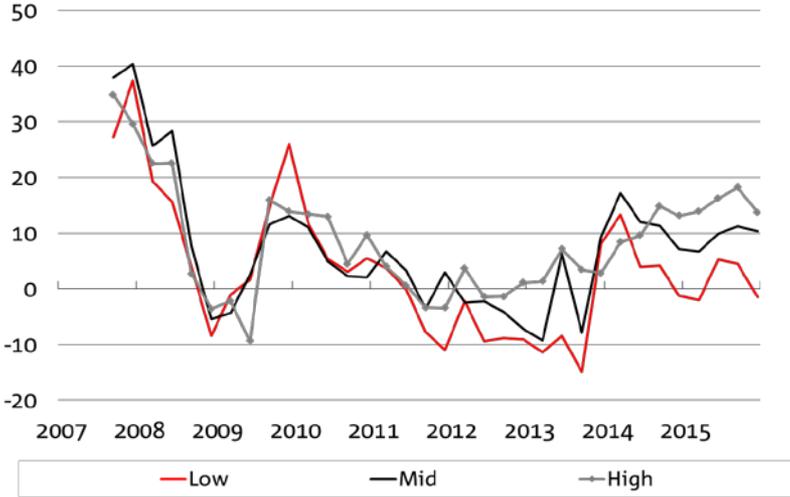
Business Conditions (net bal., sa.)



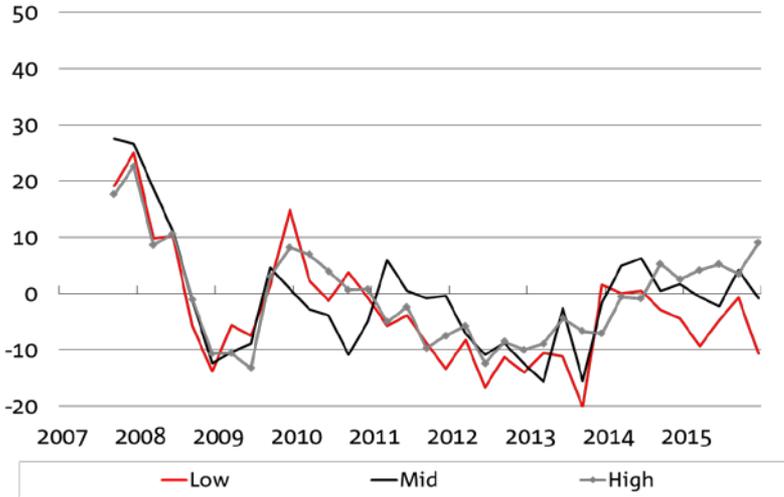
Business Confidence (net bal., sa.)



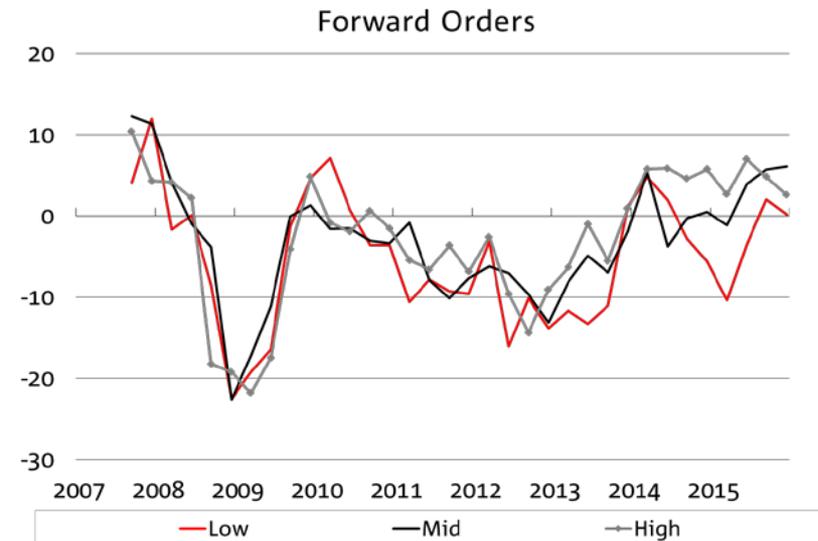
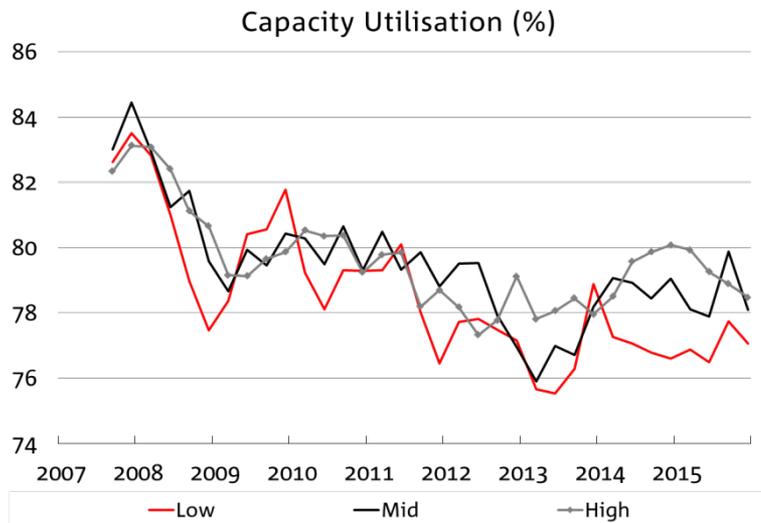
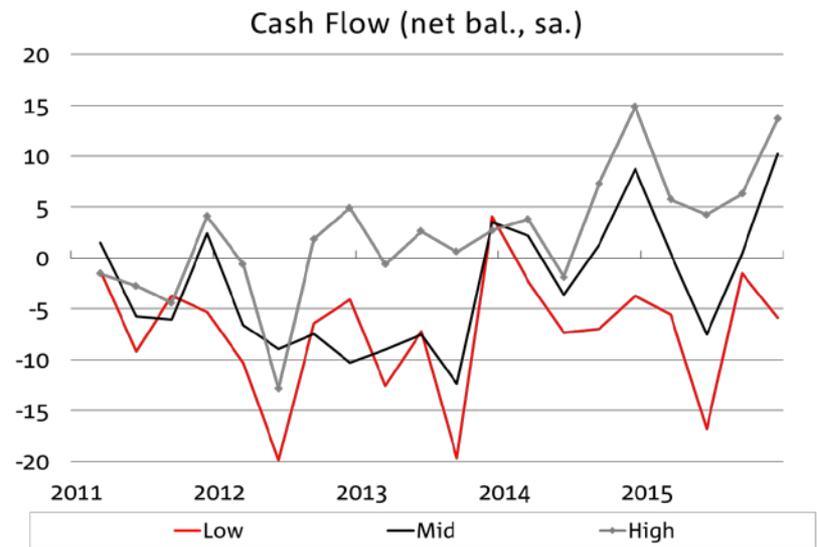
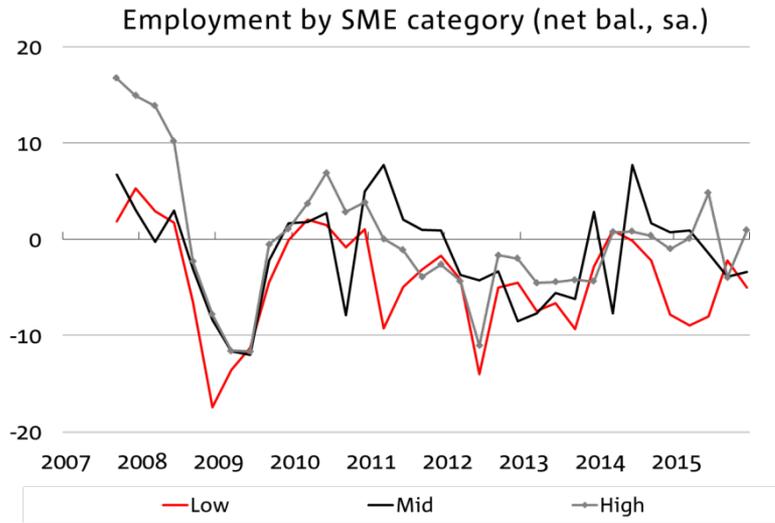
Trading Conditions (net bal., sa.)



Profitability (net bal., sa.)



Detail by firm size (cont.)



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