

NAB Quarterly SME Survey

by NAB Group Economics

Embargoed until:
11:30am Thursday 28 April 2016

Mar qtr 2016



Key Points:

- The NAB Quarterly SME Survey is the leading business survey of 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 their assessment of the outlook for investment and output.
- SME business conditions remained unchanged at +3 index points in Q1, to be still slightly below the long-term average of +4 and below that of larger rivals covered in our main Quarterly Business Survey. The components of business conditions were largely steady, with trading and profitability conditions remaining relatively robust, while employment conditions still lacked momentum. Conditions also continued to vary across business size, with "low-tier" firms facing the most challenging conditions, although their divergence from the "top-tier" firms has narrowed.
- Meanwhile, SME business confidence lost some momentum in the quarter, returning to the neutral mark, a level which is below the long-term average of +2 index points. This may reflect concerns by respondents in the quarter about financial market volatility and slowing global growth prospects.
- In level terms, the majority of SME industries continued to experience positive business conditions in Q1, except for manufacturing, retail and business services. "Accommodation, cafes and restaurants" have benefited from a pick-up in tourism lately (see Industry Focus, P5, for further detail). This sector and "health" outperformed other industries in Q1, while "transport" and "wholesale" improved the most in Q1. Meanwhile, previously strong sectors such as finance, property and business services lost some momentum.
- SME business conditions were stronger across most states in Q1, except for NSW and VIC. However, NSW, at +8 index points, still outperformed all states. WA and SA remained negative. Qld (+1) improved the most, nudging into positive territory. Confidence by state was mixed, with the large, non-mining states of NSW (at +2) and VIC (-1) showing notable declines in Q1 but NSW remaining the most confident.
- Capacity utilisation partially retraced the fall in the previous quarter to reach 79.0% in Q1. Capex by firms also improved. A pick-up in capex and forward orders indicate that SME activity could accelerate soon.

	2015 Q1	2015 Q4	2016 Q1
Business Conditions	2	3	3
Low-tier firms	-6	-6	-4
Mid-tier firms	2	2	4
High-tier firms	5	8	6
Business Confidence	3	3	0
Low-tier firms	-6	1	-4
Mid-tier firms	7	6	2
High-tier firms	3	2	0
Trading Conditions	6	10	9
Low-tier firms	-1	-1	-5
Mid-tier firms	4	12	11
High-tier firms	11	15	14
Profitability	-1	2	2
Low-tier firms	-9	-9	-4
Mid-tier firms	-1	0	1
High-tier firms	3	10	4
Employment	0	-2	-2
Low-tier firms	-8	-5	-4
Mid-tier firms	1	-4	-2
High-tier firms	1	1	-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 – Mar qtr

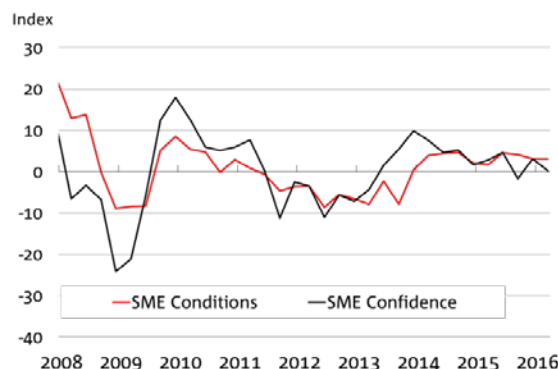


Table 2: Conditions and confidence by industry (net balance, s.a.) – Mar qtr

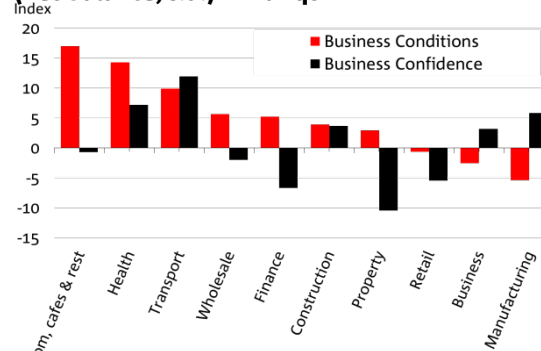
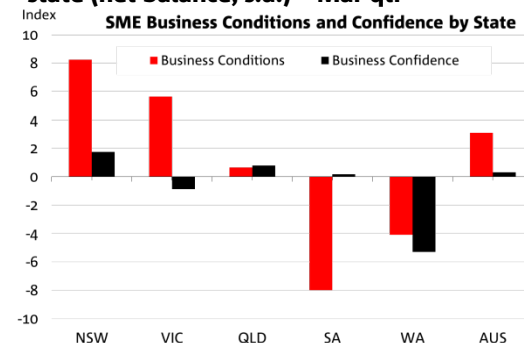
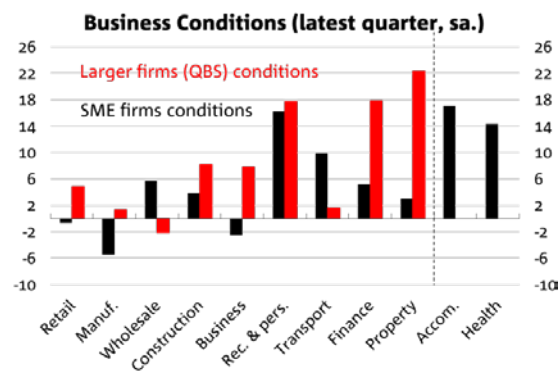
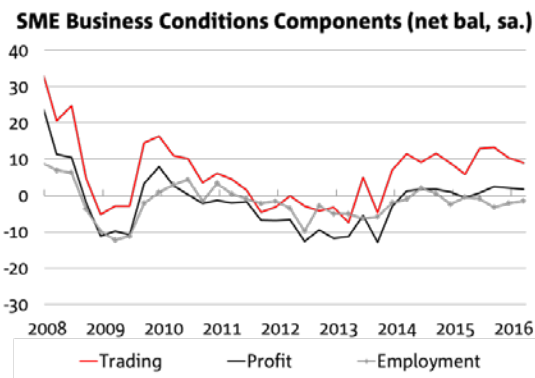
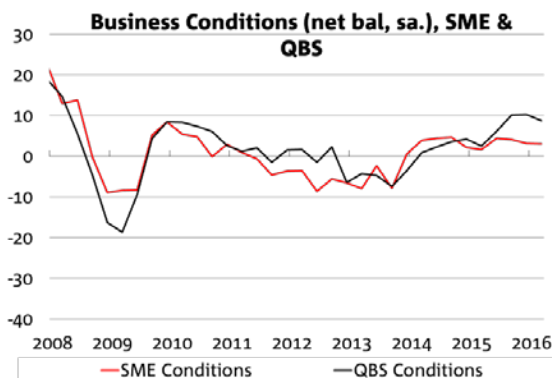


Table 3: Q3 Conditions and confidence by state (net balance, s.a.) – Mar qtr



Business and property services lost momentum, while wholesale and transport improved

- **Business conditions for SMEs stayed unchanged at +3 index points in the March quarter. Business confidence, however, did not manage to hold on to its gains in Q4 2015 and fell to the neutral mark (was +3 previously).** While SME conditions remained notably below those of general businesses indicated by the NAB Quarterly Business Survey (QBS), the gap between the two narrowed slightly, largely reflecting a slight deterioration in QBS business conditions. Conditions of SMEs in the business and professional services sectors (including finance and property), which have been performing relatively well for the past two years, have taken a significant turn for the worse this quarter. This possibly reflects the slowing momentum in the housing market which spills over onto other business services, such as legal conveyancing. However, household services, such as “accommodation, cafes and restaurants” and “health”, continued to perform very well.
- **In terms of the components that make up SME business conditions, trading conditions fell modestly in the quarter to +9, to be slightly below the long-run average.** Consistently strong trading conditions since late 2013 have resulted in marginally positive profitability for SMEs on average over the last two years, with the lower profitability index a reflection of weak margins. That said, employment conditions remained subdued, to be at odds with the recent pick-ups seen in our monthly and quarterly business surveys.
- **Overall, the survey results point to a broadening non-mining sector recovery into late 2015, although the earlier drivers of growth, such as business and professional services, appeared to have lost some momentum in Q1.** Finance, which had the strongest business conditions in Q4, recorded an 8-point fall in the March quarter to +5. Meanwhile, property and business services also showed sizeable declines of 9 and 7 points respectively to +3 and -2 index points. Accommodations/cafes/restaurants (+17) and health (+14) gained further traction to be the top performing industries in Q1. Intermediate services of wholesale (+6) and transportation (+10) showed surprisingly strong improvements to leap decidedly into positive territory, while manufacturing (at -5), which had shown some tentative improvements, fell back into negative territory to be the worst performer for the quarter. That said, leading indicators for manufacturing remained strong. **SME business conditions were stronger in most states, except for NSW and VIC. NSW (at +8) still outperformed all other states, but Qld (at +1) was the state that improved by the most to record the first positive business conditions reading in almost 2 years.** Meanwhile, WA and SA continued to be mired in negative territory at -4 and -8 index points respectively. Business confidence fell in most states in the quarter, except for the mining states of WA and SA. WA continued to be the least confident state at -5 index points.
- By industry, business confidence fell in most industries, except for construction, transport and health. Possibly reflecting the fall in oil prices in Q1, the transport sector emerged as the most confident at +12, followed by health at +7 index points. Property confidence fell by 12 points to record its first negative reading (at -10) since mid-2012, to be the least confident industry in the quarter.
- **Compared to the larger businesses in the QBS, SME business conditions were lower in all industries except for wholesale and transport. Analysis by the size of firms showed that low-tier SME firms with \$2 to 3 million annual revenue continued to report significantly weaker conditions compared to their larger counterparts. They also reported the weakest confidence in the quarter.**

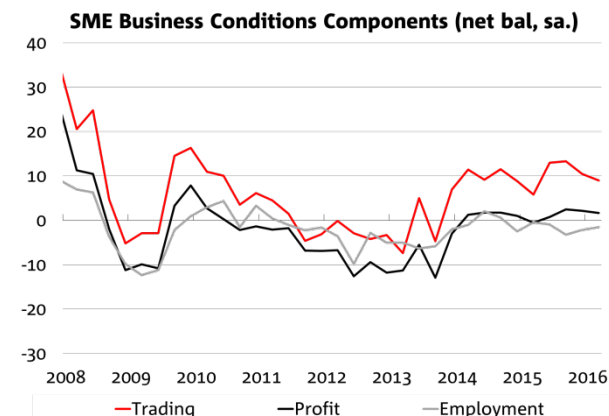


** Data are seasonally adjusted by NAB, except SME cashflow (insufficient time series available). All data are net balance indices. Fieldwork for this Survey conducted from 22 February to 10 March 2016 covering around 702 SME (non-farm) firms.

Forward and financial indicators largely on track in Q1

- In the March quarter, **SME forward orders remained largely unchanged at +4 index points, well above the long-run average of -2 index points.** This was modestly higher than 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.**
- Consistent with a deterioration in business conditions, forward orders for property and finance services fell significantly in the quarter to -6 and -9 index points respectively. Finance now has the weakest forward orders reading of all industries, and its correlation with the movement in property services suggests that the sector may have been adversely affected by the cooling of housing market activity nationally. Surprisingly, orders for accommodations/cafes/restaurants also fell into negative territory (at -1) despite a strong headline conditions figure. Meanwhile, manufacturing orders gained further momentum in the quarter to the highest in more than 6 years at +13, as a lower AUD improves the competitiveness of Australian manufactured goods. Somewhat volatile, transport orders jumped 19 points to +17 to be the best performing industry in the quarter.
- **The SME stock index remained unchanged in the quarter at +2 index points, a level consistent with a moderate pick-up in underlying demand and slightly below that of the QBS.** By industry, property services (+9), wholesale (+6) and business services (+6) reported the highest levels of stocks. Manufacturing stocks fell notably in the quarter to the neutral mark from +7 previously, which was somewhat at odds with its persistently strong forward orders index. Meanwhile, stocks were the lowest in health (-7) and finance (-1). Overall, at their current levels, the forward and financial indicators continue to point to a moderate but tentative pick-up in activity in coming months.

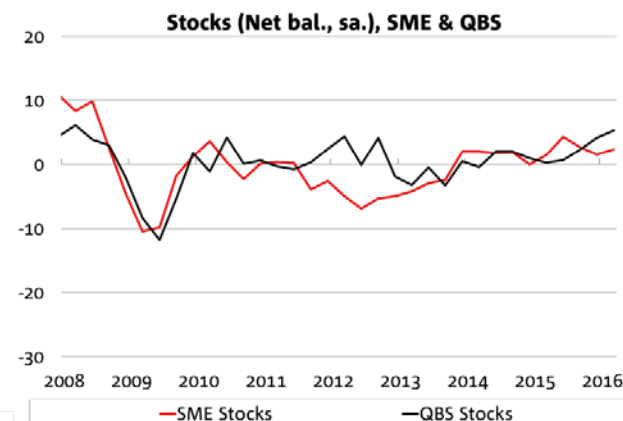
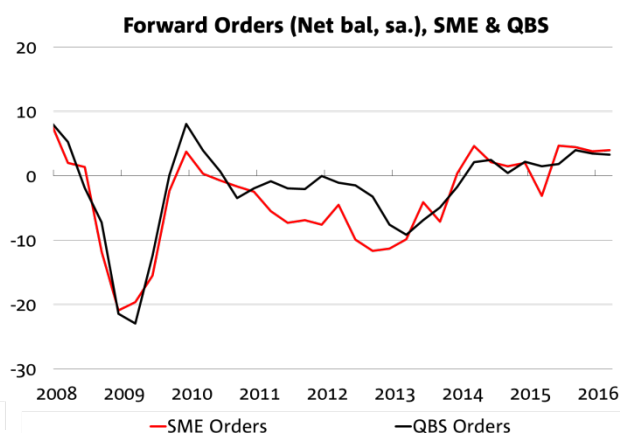
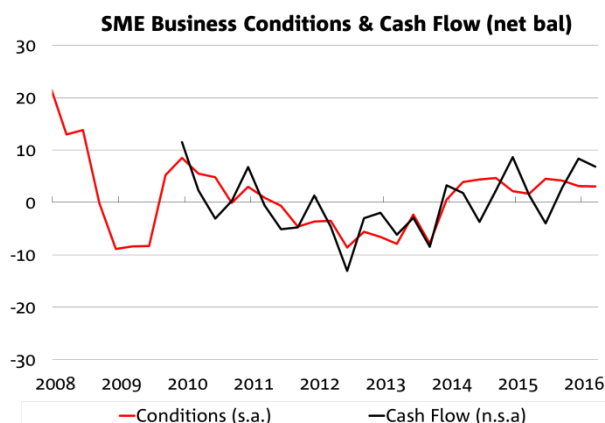
Trading conditions continued to be the key driver for overall conditions, but profitability stayed positive as well



Cash flow fell marginally but remained in positive territory

SME forward orders largely unchanged in Q1

SME stock index continued to track below that of QBS

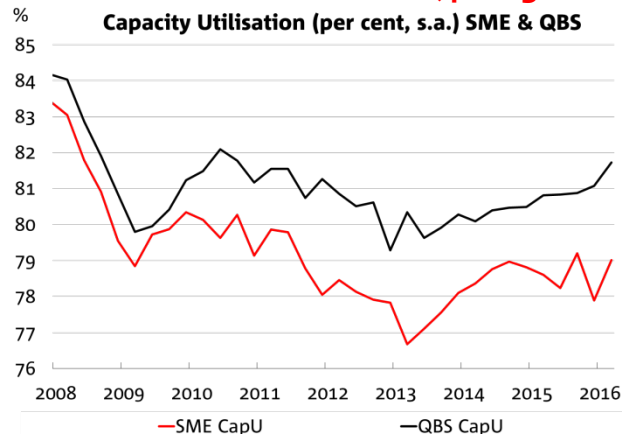


SME capacity utilisation improved moderately in Q1

- In Q1, SME capacity utilisation reversed most of the loss in the previous quarter to reach 79.0%, and in trend terms appeared to increasingly diverge from that of general businesses indicated by the QBS. SME capacity utilisation has largely tracked sideways since late 2014 despite generally favourable trading conditions, with firms continuing to report the lack of the demand as their greatest constraint to output expansion. By industry, health continued to rank top at 85.0%, but this level was significantly below its recent peak of 88.1% achieved in Q3 2015. This was followed by transportation services (up 6.9 ppts to 83.9%), presumably boosted by sustained period of low oil prices. While most other services sectors generally fared above the industry average, property services recorded a sharp fall of 4.3ppts to 76.8%. Meanwhile manufacturing continued to report the weakest capacity utilisation out of all industries at 75.1%.
- Analysis by the size of firms suggests a growing gap between low-tier SMEs and the top-tier ones to the widest since the start of the series. In the quarter, capacity utilisation of low-tier SMEs fell to 76.4%, its lowest point since late 2013, while that of mid and high-tier SMEs gained notably to 78.7% and 80.3% respectively.
- Capital expenditure (capex) by SMEs rose modestly in the March quarter to stay slightly below the capex reading for larger businesses as indicated by the QBS. It is unclear at the moment whether the recent pick-ups in the momentum of SME and QBS capex can be sustained, but their positive readings 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. Looking through the volatility, business, accommodation/cafes/restaurants and transport services sectors are on a rising trend, retail, manufacturing, finance and wholesale tracking sideways, while construction, property services and health are trending downwards. At -2 index points, retail had the lowest capex reading out of all industries, while transport is the highest at +34. Aggregate longer-term capex intentions improved, with 12-month capex expectations picking up to +16 in the quarter from +9 in the same quarter last year.

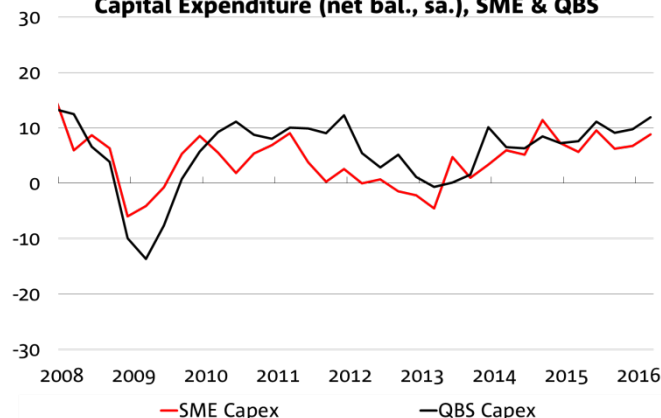
SME capacity utilisation largely reversed the fall in Q4 2015

Capacity Utilisation (per cent, s.a.) SME & QBS



Capex points to moderate expansion in near-term activity

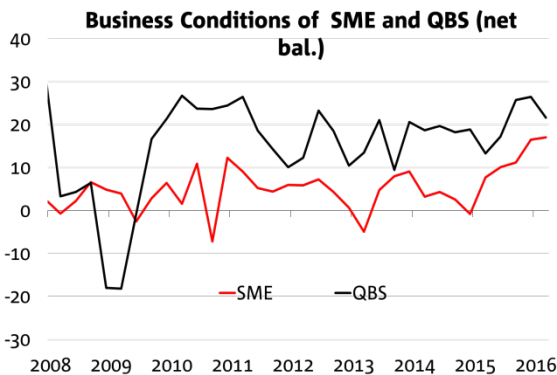
Capital Expenditure (net bal., sa.), SME & QBS



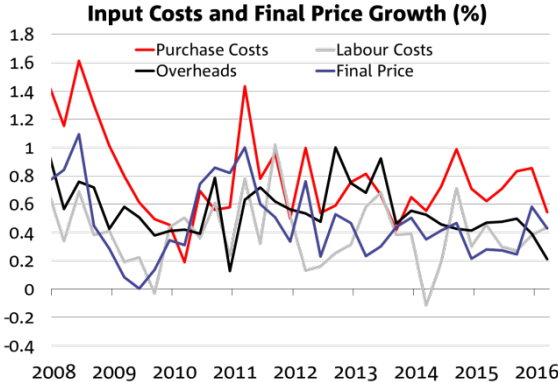
Industry Focus : Accommodation/Cafes/Restaurants

- Since the beginning of 2015, SMEs in the accommodation/cafes/restaurants sector have been experiencing a steady improvement in their business conditions, albeit still performing below that of their larger counterparts (see chart on top LHS). **Benefitting from a pick-up in tourism activity both from internal and external sources on the back of the greatly depreciated AUD since 2013, business conditions of the sector outperformed all industries in Q1.**
- AUD depreciation, particularly against the RMB, has fuelled the surge in visitor numbers coming from China. Short-term visitor arrivals from China have doubled over the last 4 years, now running at an annual rate of over 1 million visitors and getting close to displacing New Zealand as the biggest source of arrivals.
- While a lower AUD has improved the competitiveness of the accommodation/cafes/restaurants sector, it has also maintained purchase cost growth at a relatively high level in the past two years, although it did fall quite notably in Q1 (see chart at top RHS). Encouragingly, however, growth in overheads appeared to be slowing, while labour costs growth was also reasonably contained. This suggests that the availability of suitable labour is not a constraint to the SMEs in hospitality sectors at the moment. Meanwhile, final price growth seemed to have gained some momentum since late last year, but still slightly softer than the long-term average of 0.5% (q/q).
- **Overall, profitability of the sector has also gained significant traction since the beginning of 2015 as business conditions improved, to be close to its highest level since 2010.** This coincided with a rising trend in the sector's cashflow (non-seasonally adjusted) performance. As a result of stronger profitability, SMEs in the sector have also increased their headcount notably since then.
- Forward-looking indicators for the sector seemed mixed. Forward orders and stocks failed to lift despite strong conditions (although stocks did improve a fair bit in Q1), but the latter could be a reflection of the perishable nature of the stocks in restaurants and cafes. However, a pick-up in capacity utilisation rate suggests that firms are operating in an expansionary mode.

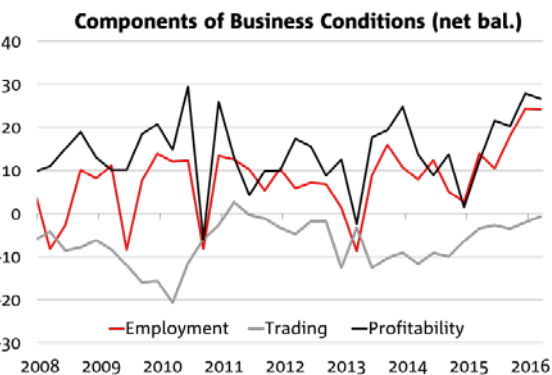
Accommodation/cafes/restaurants SMEs are underperforming their larger industry counterparts



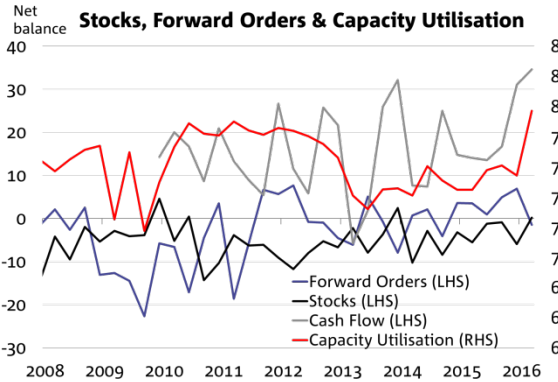
Input costs for accommodation SMEs are contained, while final price growth has also gained momentum



A marked improvement in profitability has encouraged more hiring. Trading conditions have steadily improved but remain subdued.



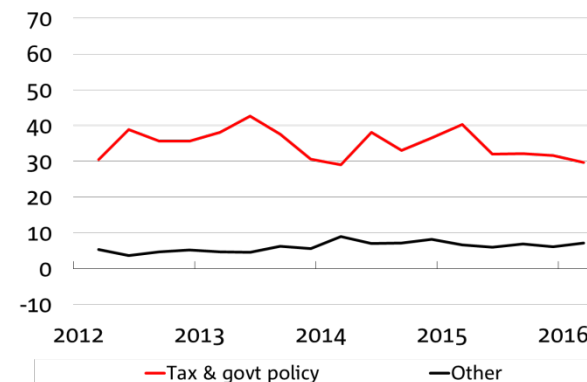
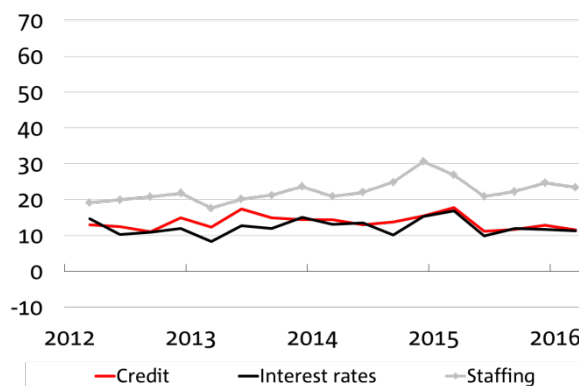
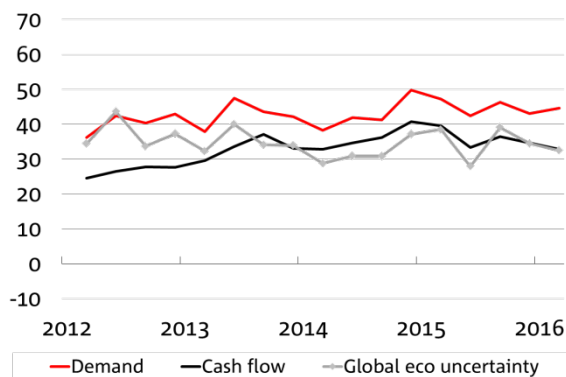
An uptick in capacity utilisation indicates that firms are expanding their activity



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

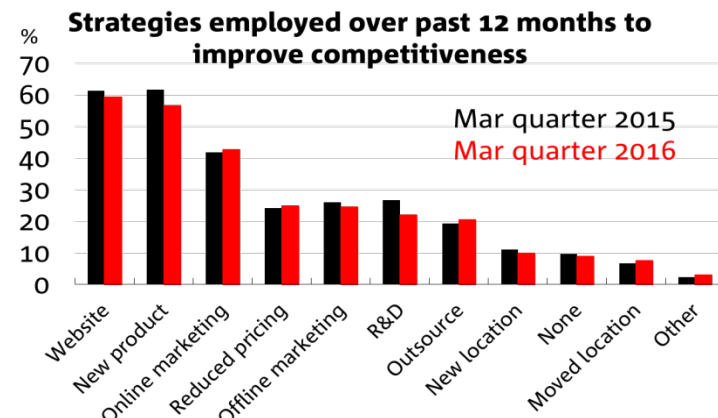
- The global financial and commodity market rout earlier this year did not seem to significantly alter the perceptions of SMEs regarding the most constraining factors affecting their long-term decisions. SMEs reported an improvement in most of the significant constraints in the quarter, except for "demand" and "other". While the lack of demand has been considered the most constraining factor since mid-2012, it has shown some amelioration since its peak in mid-2013.
- Supply-side factors, including credit, staffing availability, tax and government policy, as well as interest rates, continued to be relatively benign overall.

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



Pattern in SMEs' business strategies is largely stable

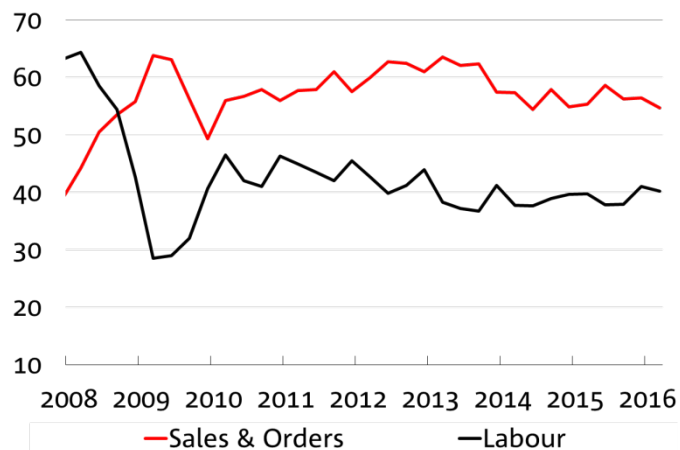
- In the March quarter, we again asked firms whether they had employed any new strategies over the past 12 months to improve their competitiveness in the market.
- The results were not too different from the same quarter in 2015, with less resource-intensive strategies such as website and new product still being favoured, compared to the more resource-intensive ones such as R&D, new location and outsourcing. The use of some of these strategies has lessened somewhat, however, suggesting that perhaps competitive pressures amongst firms have ameliorated to a degree.



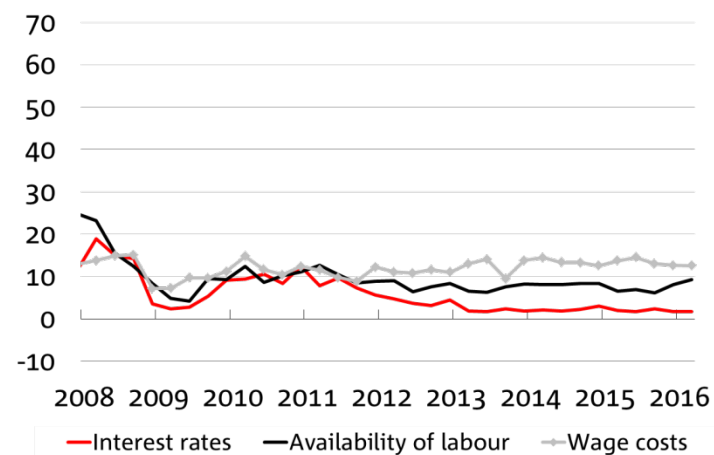
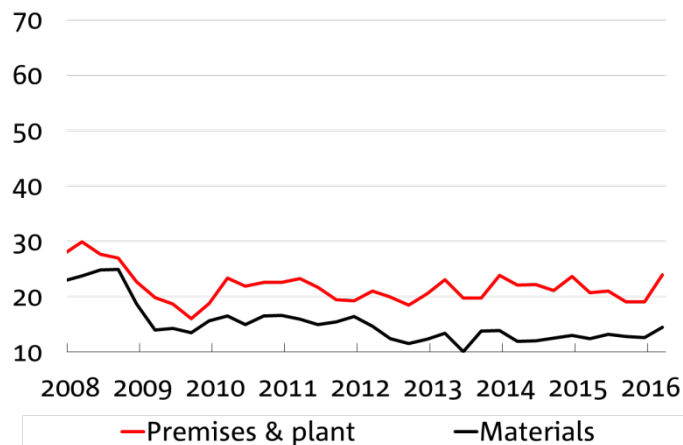
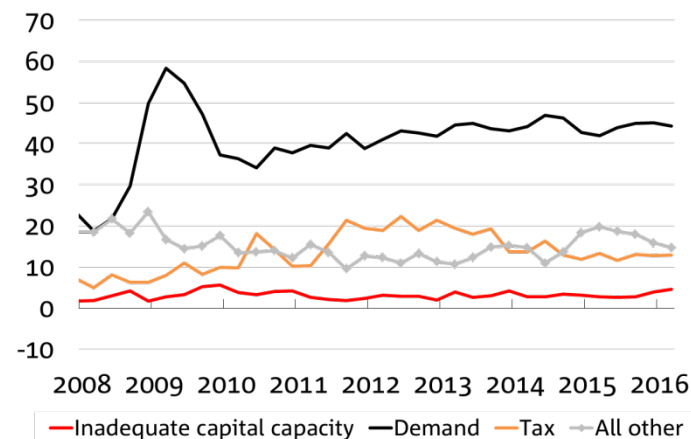
* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

Constraints facing SMEs' output and profitability

Constraint on output (% of firms)

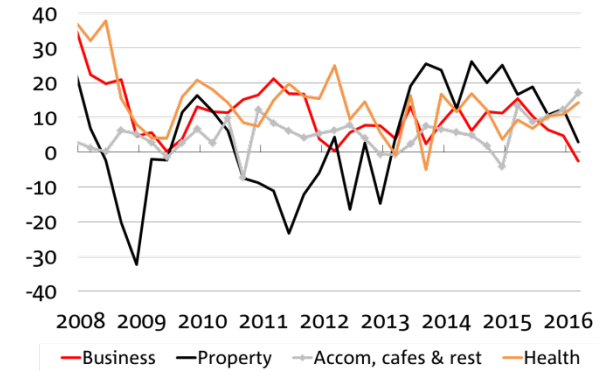
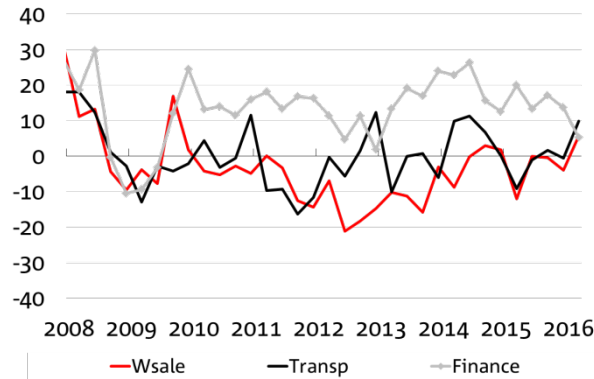
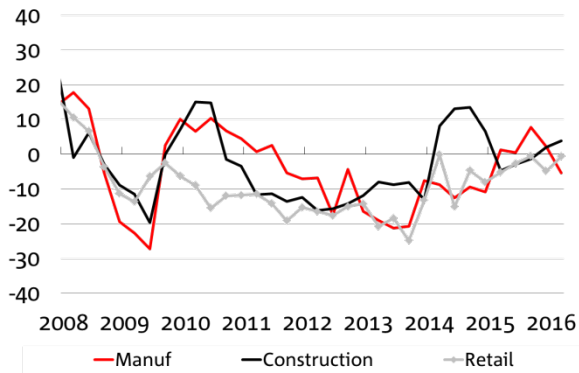


Constraint on profitability (% of firms)

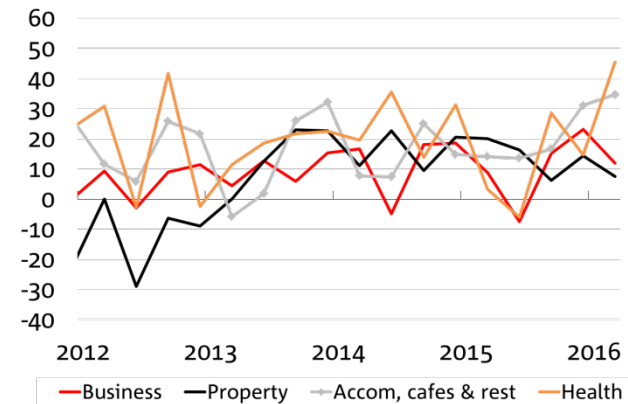
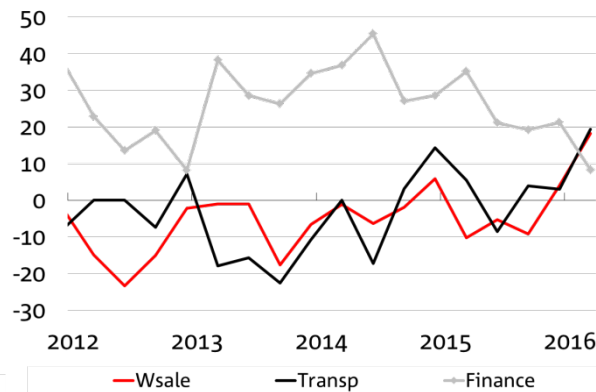
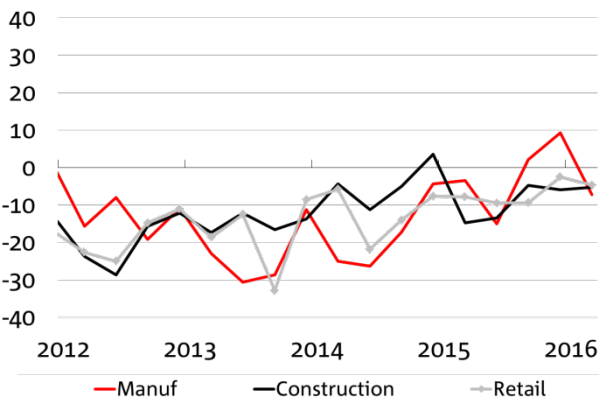


Detail by industry

Business conditions by industry (net balance)

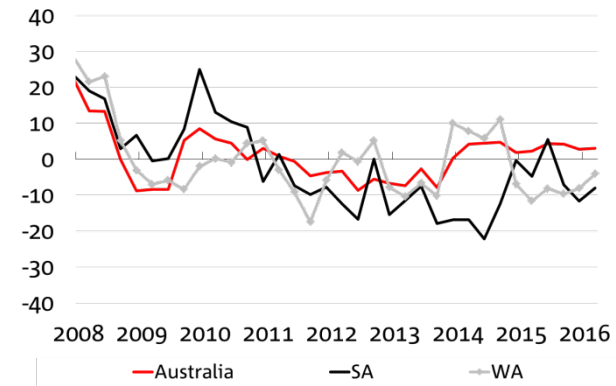
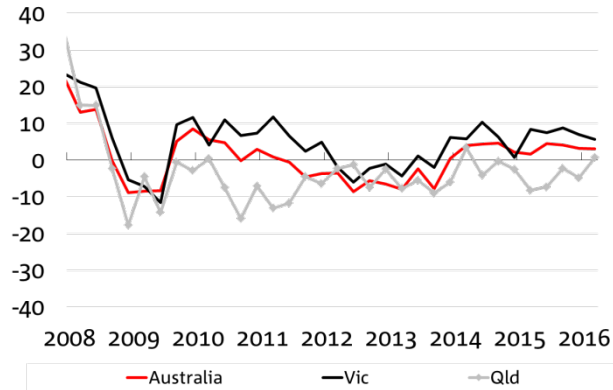
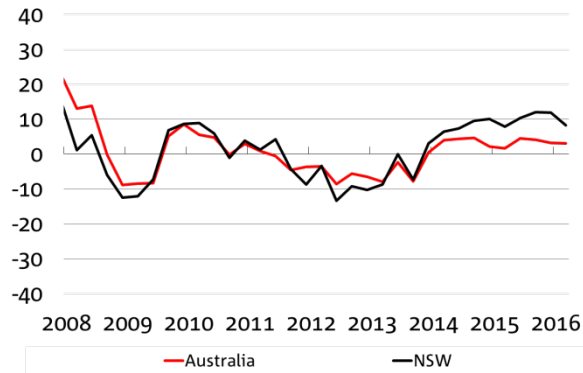


Business confidence by industry (net balance)

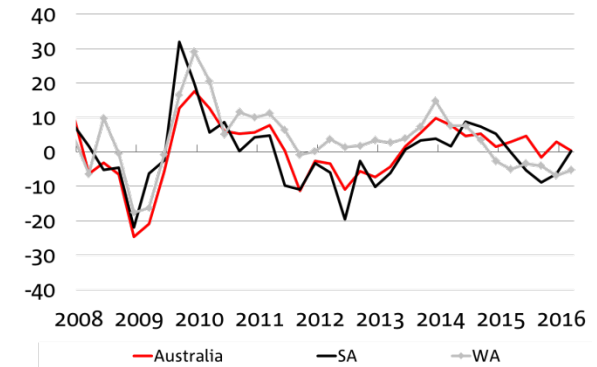
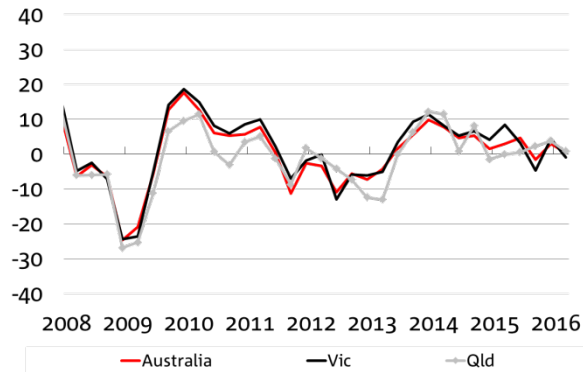
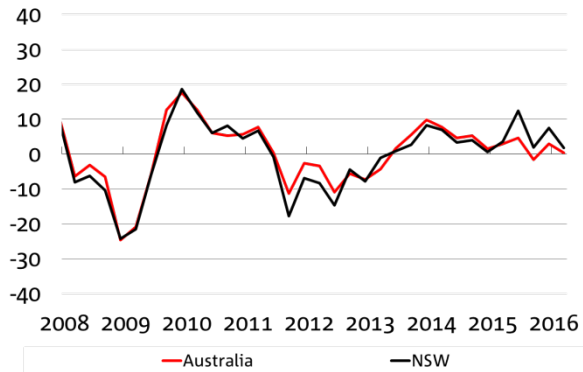


Detail by state

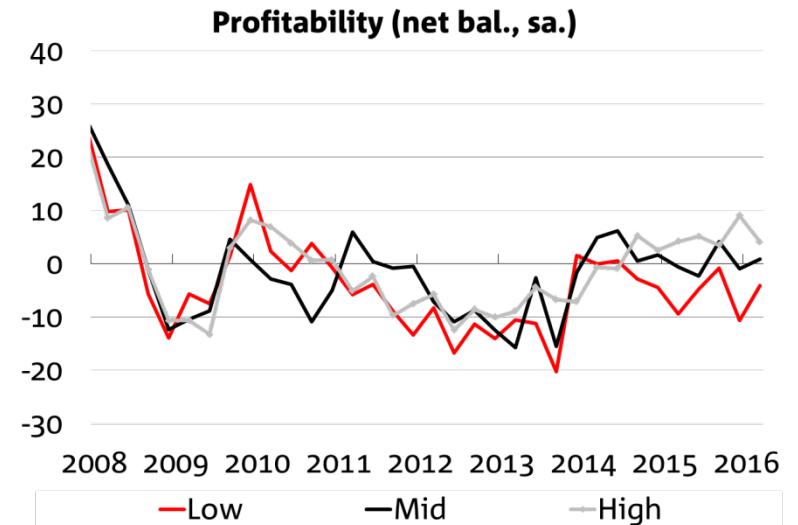
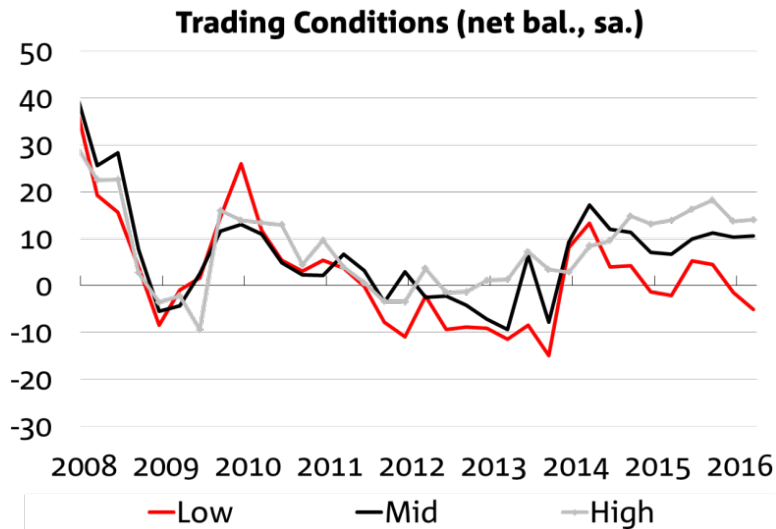
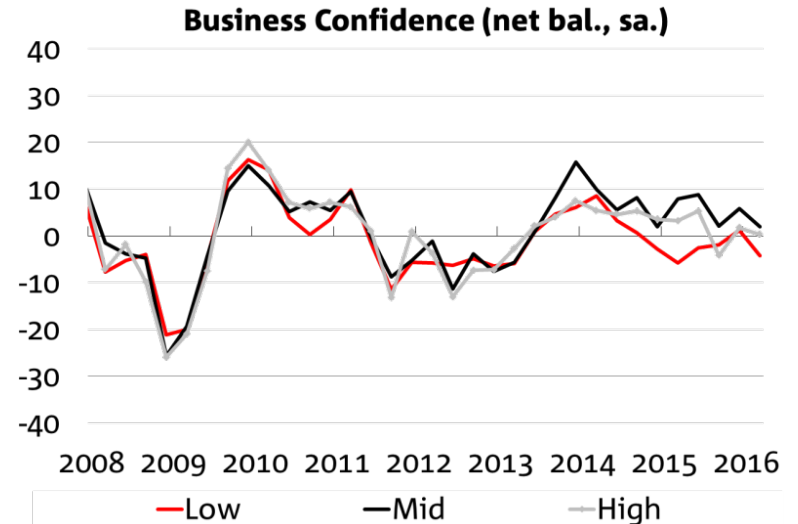
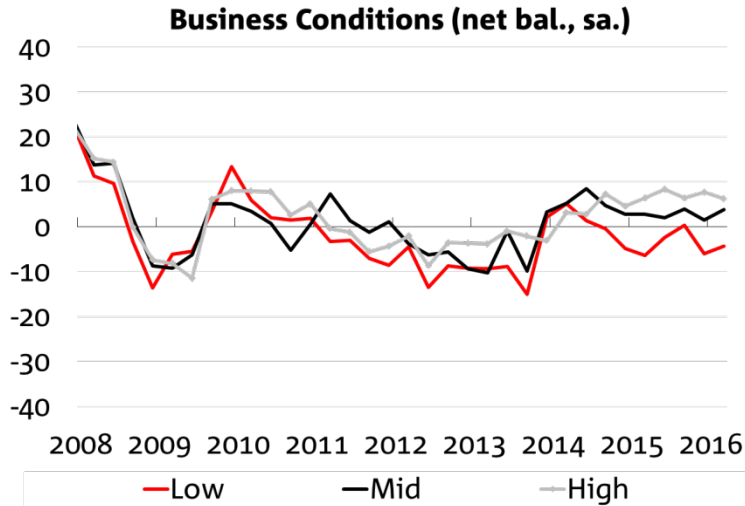
Business conditions by state (net balance)



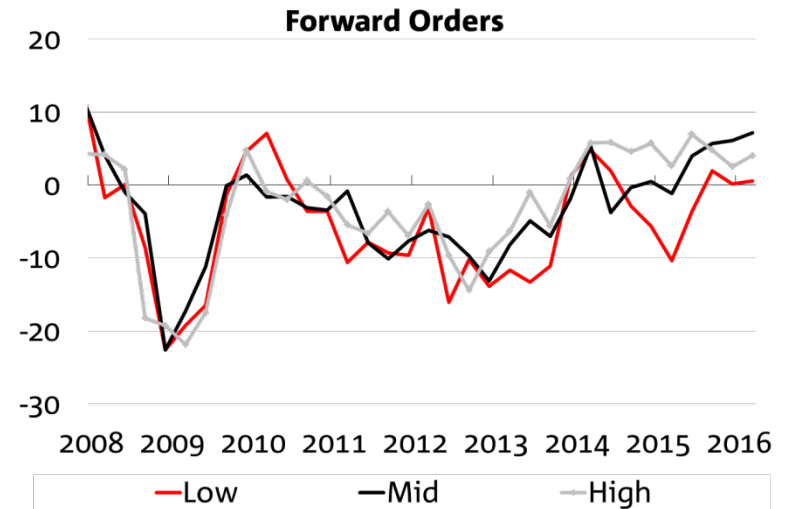
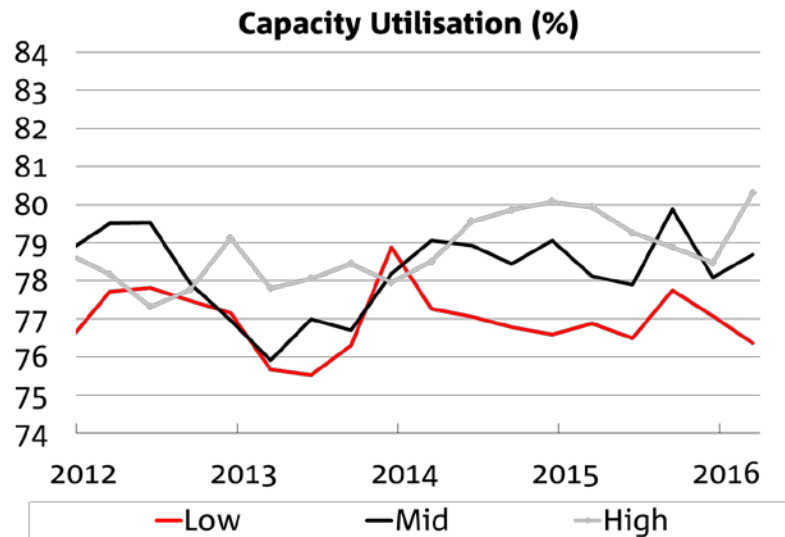
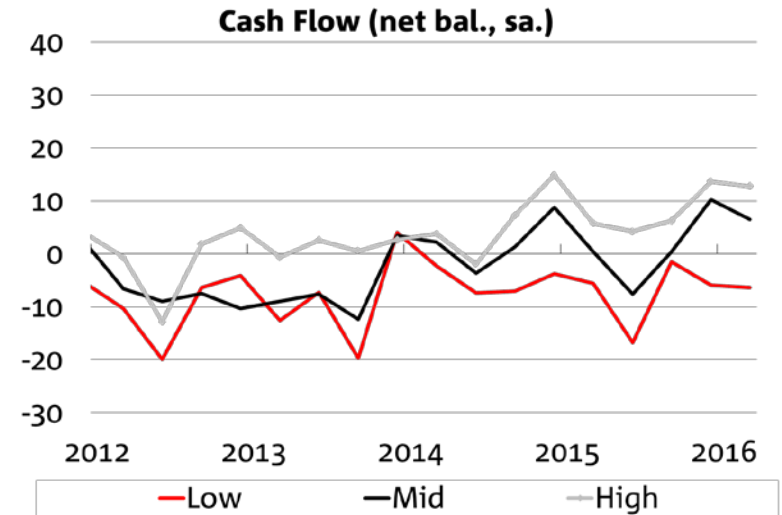
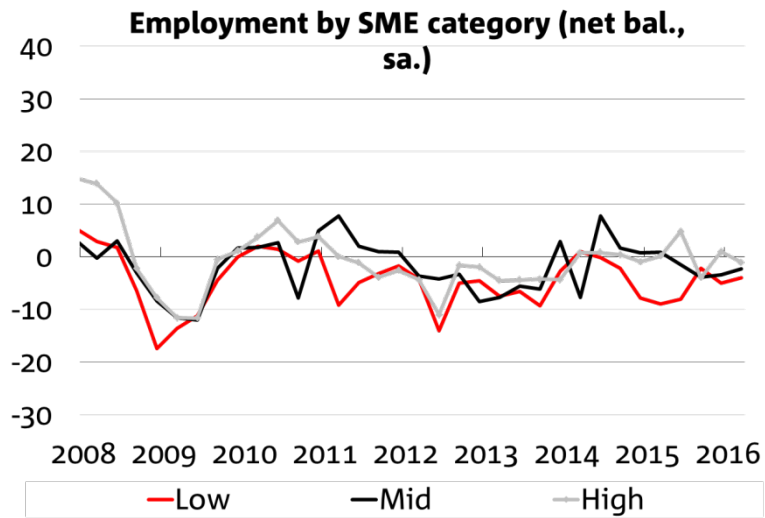
Business confidence by state (net balance)



Detail by SME firm size



Detail by firm size (cont.)



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