NAB Quarterly SME Survey

by NAB Group Economics

Embargoed until:
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Jun qtr 2016

National Australia Bank

Key Points:

- **The NAB SME Survey revealed very strong results across a wide range of indicators in Q2, suggesting that the non-mining recovery is broadening to include smaller businesses.**
- **Business conditions for SMEs gained further traction in Q2, rising by 2 points to +6 index points, a level not seen since 2010 and comfortably above the long-run average of +4.** It is especially encouraging that low and mid-tier firms reported notable improvements in conditions and confidence in the quarter. In particular, low-tier firms reported positive business conditions for the first time in 2 years.
- All three components of business conditions rose in the quarter. **Trading and profitability conditions surged ahead,** reaching levels not seen since 2009. **Employment conditions however remain lacklustre**. The optics of conditions by firm size were also quite encouraging, with all size categories reporting positive results for trading and profitability conditions, although demand for labour by low-tier firms remains soft.
- **Meanwhile, SME business confidence rebounded to +5, above the long-term average of +2 index points and more than reversing the fall in the previous quarter.** It is worth pointing out that the survey was conducted prior to the Brexit decision and federal election and therefore does not reflect the possible shifts in sentiment due to these political events. However, our latest monthly NAB Business survey for June, which was polled during Brexit (but before the election), did not show an adverse impact on confidence.
- **In level terms, all SME industries except for construction reported positive business conditions in Q2.** The health sector outperformed other industries in the quarter, followed closely by business services, while retail was the weakest after construction. Meanwhile, there has been more evidence of late that the wholesale sector is experiencing a recovery in its business conditions.
- **All states, except for WA, reported better business conditions in Q2, with QLD showing the biggest improvement again (up 10 points to +11).** NSW and VIC continued to outperform, while WA has lagged further behind the national average. All states were more confident in the quarter, with VIC being the standout, while WA was the least confident and the only state to report negative confidence.
- **Leading indicators were stronger in the quarter as well, with capacity utilisation rising to levels last seen in 2011, while capex reached the highest level since 2007.** Overall, SME input price indicators point to relatively contained price pressures, while easing price growth for retailers is consistent with the subdued inflation outlook.

	2015	2016	2016
	Q2	Q1	Q2
Business Conditions	3	4	6
Low-tier firms	-3	-5	1
Mid-tier irms	0	6	10
High-tier firms	7	7	6
Business Confidence	4	1	5
Low-tier firms	-3	-4	5
Mid-tier irms	8	3	7
High-tier firms	4	1	4
Trading Conditions	11	11	16
Low-tier firms	5	-5	5
Mid-tier irms	8	14	21
High-tier firms	15	17	16
Profitability	0	2	6
Low-tier firms	-6	-4	2
Mid-tier irms	-4	3	9
High-tier firms	5	5	5
Employment	-1	-2	-1
Low-tier firms	-7	-5	-5
Mid-tier irms	-2	-2	1
High-tier firms	4	-1	0

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 – Jun qtr

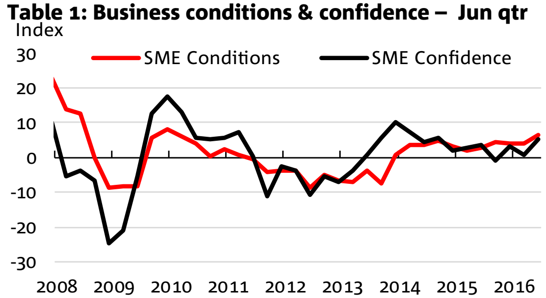


Table 2: Conditions and confidence by industry (net balance, s.a.) – Jun qtr

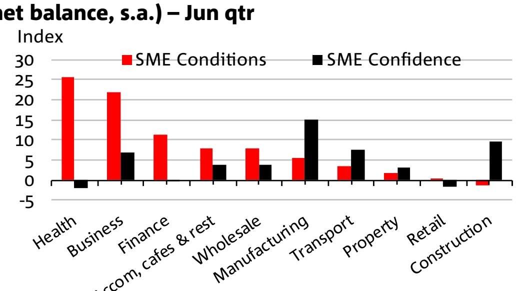
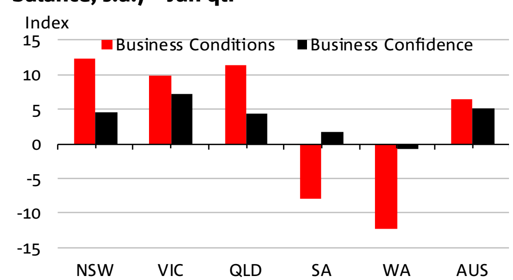


Table 3: Conditions and confidence by state (net balance, s.a.) – Jun qtr



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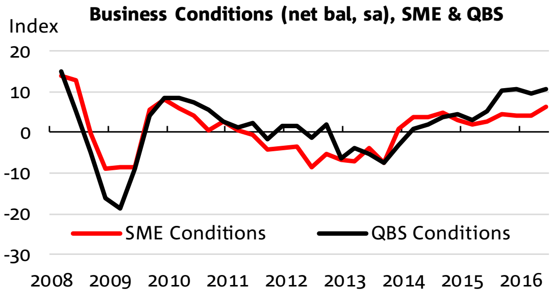
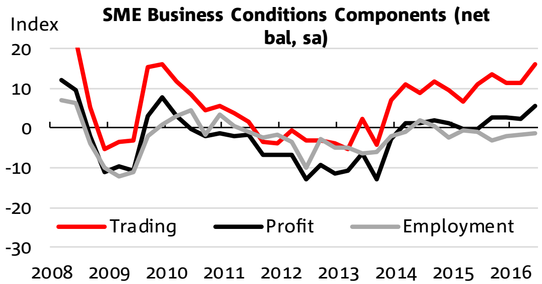
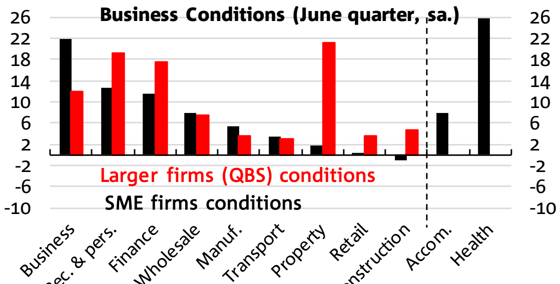
Broad-based improvements in business conditions and confidence

- **Business conditions for SMEs gained further traction in Q2, rising by 2 points to +6 index points, a level not seen since 2010 and comfortably above the long-run average of +4.** SME business conditions have been largely range-bound between +2 and +4 over the last two years to Q1, hence the Q2 result could be an inflection point for an upturn in conditions. We are particularly encouraged by the results for low-tier SMEs, which recorded the first positive reading in business conditions in two years, potentially signalling that small firms are finally reaping the benefits of the broadening non-mining recovery. While SME conditions remained below those of general businesses indicated by the NAB Quarterly Business Survey (QBS), the gap between the two has narrowed further in Q2. **Similarly, SME business confidence improved in the quarter to +5, exceeding its long-term average of +2.**
- **All the three components that make up SME business conditions rose in the quarter, with trading conditions (up 5 points to +16) and profitability (up 4 points to +6) reaching levels not seen since late 2009 and well-above their respective long-term averages.** So far, strong trading and profitability conditions have had limited impact on SME labour demand, with the employment index only rising by 1 point to -1, mired in negative territory for the seventh consecutive quarter. The lack of momentum in SME employment conditions are seemingly at odds with the relatively more robust employment conditions reported by general businesses in the QBS and official employment data from the ABS, possibly reflecting weaker financial capacity of SMEs to hire new employees or a greater difficulty for them to find suitable labour.
- **SME business conditions were stronger in most states in the quarter, except for WA. As per the previous quarter, QLD again showed the biggest improvement (up 10 points to +11) to be the second strongest state after NSW.** The eastern states of NSW and VIC continued to outperform, while WA has lagged further behind the national average and was the weakest in the quarter. All states were more confident in the quarter, with VIC being the standout, while WA was the least confident and the only state to report negative confidence.
- **Most SME industry sectors reported better conditions in the quarter,** with services sectors continuing to outperform more traditional sectors in general. While tertiary services such as business services, health, finance and property have performed well for some time, intermediate services such as wholesale have been playing catch-up in the last 2 quarters. Wholesale conditions, in particular, have picked up strongly, supported by more favourable profitability and trading conditions. Health (up 7 points to +26) reported the strongest business conditions in Q2, followed by business services (up 24 to +22). The latter was also the biggest mover in the quarter. Meanwhile, construction (which includes mining and non-mining construction) fell by 3 points to -1, to be the only sector with a negative reading in the quarter. This potentially reflects the drag from the downturn in mining investment.
- **Compared to the larger businesses in the QBS, SME business conditions outperformed general businesses in business services, wholesale and manufacturing.** Analysis by firm size showed that low-tier SME firms continued to report weaker conditions compared to their larger counterparts, although their first positive reading in 2 years could be signal of further recovery. Encouragingly, they have also reported stronger confidence than high-tier SMEs in the quarter. **By industry, business confidence rose in most industries, except for transport and health. Possibly reflecting the resumption of strong growth in the housing market in the last 2 quarters after a weak Q4 last year, the property sector jumped the most (by 12 points to +3), but its overall confidence level remained well below the peak in 2014.** Somewhat surprisingly, manufacturing (up 6 points to +15) was the most confident sector in the quarter. That said, manufacturing conditions have largely been positive since late 2015, albeit at low levels still, possibly reflecting improved competitiveness in the sector from a low AUD. Meanwhile, health and retail, both at -2, were the least confident.





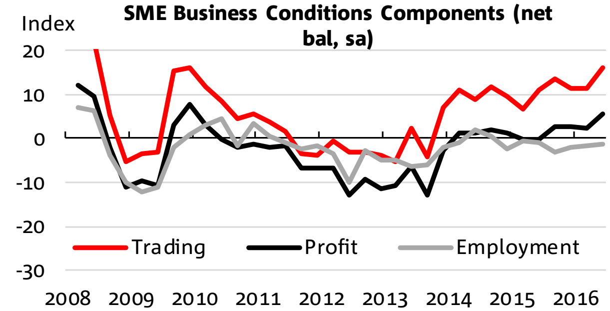


** Data are seasonally adjusted by NAB, except SME cashflow (insufficient time series available). All data are net balance indices. Fieldwork for this Survey conducted from 23 May to 9 June 2016 covering around 692 SME (non-farm) firms.

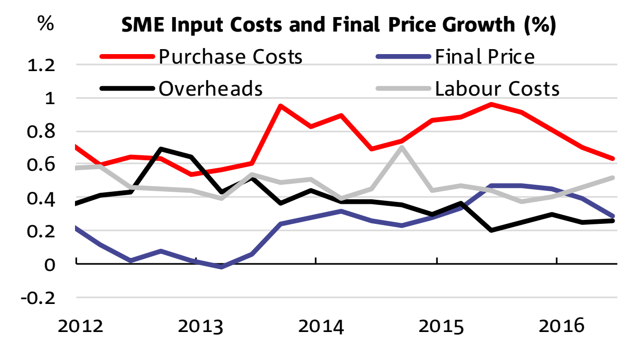
Forward and financial indicators point to a moderate pick-up in activity

- **In the June quarter, SME forward orders fell by 2 points to +2 index points, consistent with the long-term average of -2 index points and the result for general businesses as reported in the QBS.** The generally positive readings for forward orders since late 2013 are consistent with a moderate recovery in real economic activity.
- **By industry, the quarterly movements were mixed, but most industries reported positive forward orders.** Forward orders for manufacturing and business services were the strongest to be +8 at +7 index points respectively, although the latter recorded a relatively sharp fall of 6 points. Meanwhile, finance (up 9 to be at 0) and property (up 7 to +1) recorded the largest gains in the quarter, likely reflecting the turnaround in the housing market after a temporary slowdown late last year. Forward orders for transport fell the most (down 17 points to the neutral point), but this series is quite volatile. Meanwhile accommodation and retail, both at -1, were the weakest in the quarter. This is consistent with the lacklustre conditions and confidence experienced by the retail sector at the moment.
- **The SME stock index improved marginally to +4 index points, a level consistent with a moderate pick-up in underlying demand and on par with that of the QBS.** The improvement was largely driven by manufacturing and wholesale, which jumped by 9 and 7 points respectively to reach +12 and +16. The stock index for wholesale was also the highest in the quarter, underpinned by strong trading conditions and forward orders. Stocks for property services (down by 6 to +3) and construction (down 5 to -8) fell by the most in the quarter, with the latter the weakest across industries, followed closely by health at -6.
- The non-seasonally adjusted cash flow index was the strongest in Q2 for health (at +29), followed by business services (+18), and the weakest for manufacturing (-10) and retail (-8).
- **Overall, SME input price indicators point to relatively contained price pressures.** Growth in purchase costs has moderated significantly from the recent peak in mid-2015, overheads growth has largely been stable, although there were tentative signs of a pick-up in labour costs in Q2. Meanwhile, continuously modest growth in final prices is consistent with a subdued inflation outlook.

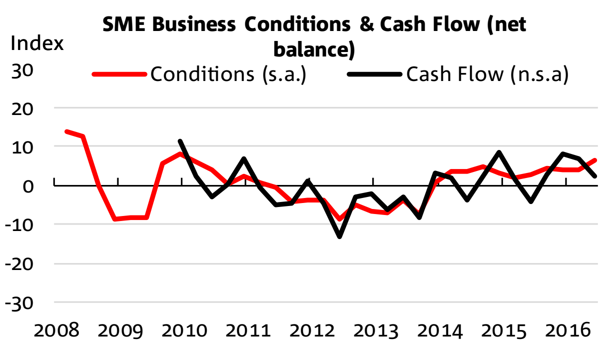
SME trading and profitability conditions robust, employment remains lacklustre



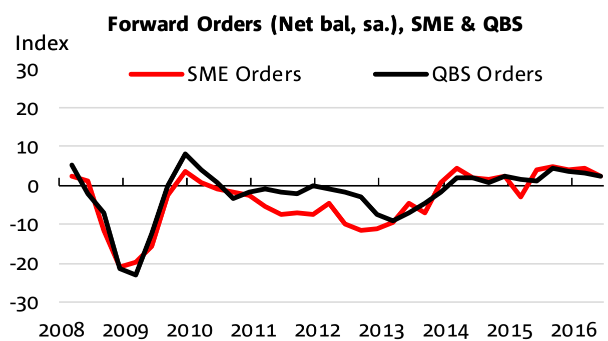
SME price indicators point to contained price pressures



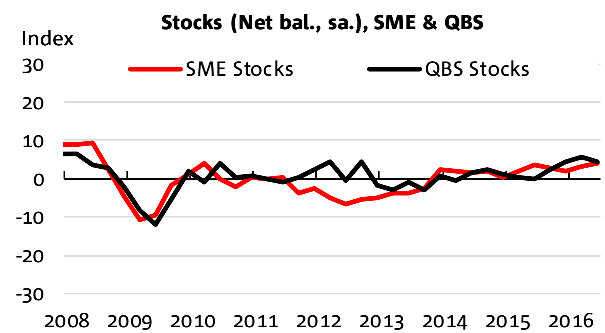
Cash flow lost some traction but remained in positive territory



SME forward orders fell marginally in Q2



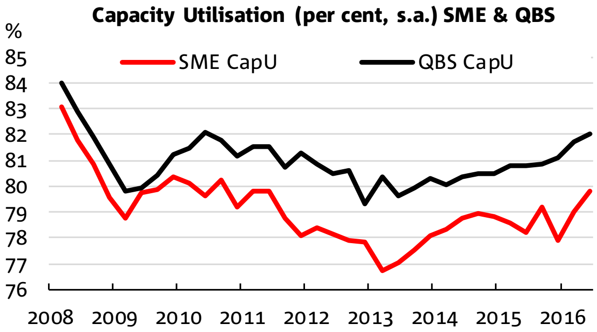
SME stock index closed the gap with QBS



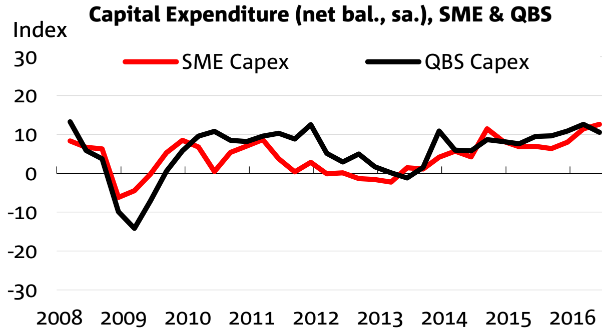
SME capacity utilisation gained further momentum in Q2

- **SME capacity utilisation improved for the second consecutive quarter, rising by 0.8 ppt to reach 79.8%, the highest level since mid-2011 , although it still remained well below that of general businesses indicated by the QBS.** SME capacity utilisation has largely tracked sideways since late 2014, but the pick-up in the last two quarters could be a signal that sustained positive trading conditions are finally filtering into an acceleration in activity. Most industries are now above their long-term averages, except for construction, wholesale and accommodation. After trending downwards over 2015, capacity utilisation for health SMEs surged in the last two quarters to reach 89.3% in Q2, the highest across industries and well above the long-term average of 87.6%. This was followed by business services (up 3.6ppt to be at 85.8%). Capacity utilisation in the tertiary services sectors, led by health, have generally outpaced intermediate services and goods sectors. That said, accommodation and wholesale reported the weakest capacity utilisation out of all industries at 76.2% and 76.9% respectively.
- **Capacity utilisation for low-tier firms appears to have made some inroads in Q2 after consistently underperforming mid and high-tier firms between early 2014 and Q2 2016.** Albeit somewhat volatile, the capacity utilisation index for low-tier firm surged by 2.4 ppt to 79.1% to tie with mid-tier firms and narrow its gap with high-tier firms (at 80.6%). This is consistent with a notable improvement in the business conditions experienced by low-tier firms in the quarter. **Capital expenditure (capex) by SMEs rose further in the June quarter to exceed the capex reading for larger businesses as indicated by the QBS.**
- The rising trend in capex suggests that SME activity is now expanding on a firmer footing. Longer-term capex intentions also improved, with 12-month capex expectations picking up to +17 in Q2 from +13 in the same quarter last year.
- Looking through the quarterly volatility, retail, wholesale, health, property services and manufacturing are showing rising trends in their capex. Meanwhile, capex for accommodation, construction, business services and transport services are tracking sideways while financial services appears to be on a mild downward trend. At -1 index points, construction had the lowest capex reading out of all industries, followed by retail at -8. Capex for property services sector was the highest at +26.

SME capacity utilisation highest since 2011



Rising capex points to accelerating activity in the near term



Industry Focus : Wholesale

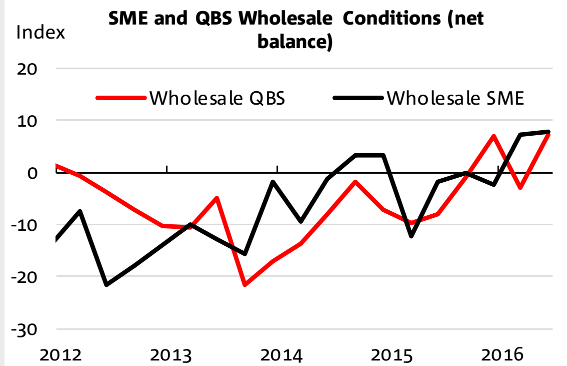
- After its most recent trough in Q1 2015, SMEs in the wholesale sector have reported gradual improvements in their business conditions, to be broadly in line with the conditions experienced by their larger counterparts (see chart at top LHS). **This represents the strongest reading by wholesalers since late 2009.**

- **Wholesalers experienced a soft patch in business conditions between 2013 and 2015, weighed down by higher import costs due to a lower AUD which they were unable to pass on in full to the retail sector.** This is evident by the relatively strong growth in the purchase costs borne by the sector compared to final price (see chart at top RHS). Over the last two quarters, growth in these two indicators appears to have slowed substantially and the gap between them narrowed, which in turn suggests greater pass-through of costs to the retail sector. Meanwhile, the growth in overheads seems to have picked up pace of late. Nonetheless purchase costs would represent a significantly higher share of overall costs compared to overheads in the wholesale sector, hence the benefits of an amelioration in the growth of purchase costs and greater cost pass-through to the retail sector are likely to outweigh the effects of an acceleration in overheads.

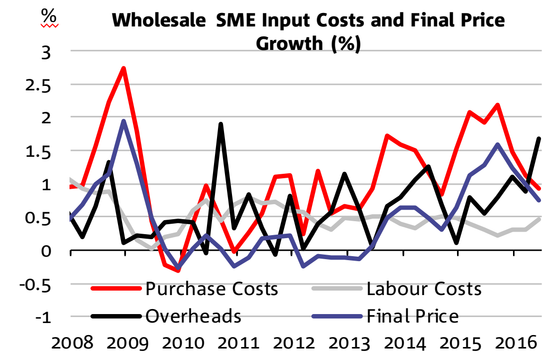
- As a result, profitability of the wholesale sector has turned positive in the last two quarters, after the last positive profitability reading was recorded in Q4 2014. This has coincided with a rising trend in the sector's cash flow index (non-seasonally adjusted). Despite improved financial performance, labour demand by the sector remains soft (see chart at bottom LHS).

- Trends in a number of forward-looking indicators for the sector are generally positive. Forward orders and stocks continue to rise gradually, although this has failed to lead to a more notable rise in the capacity utilisation rate. At 76.9% in the quarter, the sector's capacity utilisation rate was still below long-term average and among the lowest across industries.

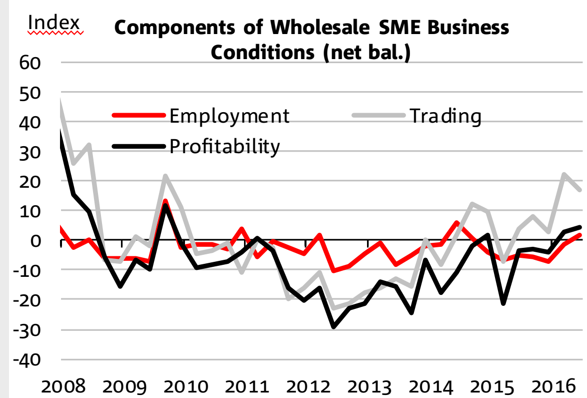
Wholesale SMEs are on par with their larger counterparts



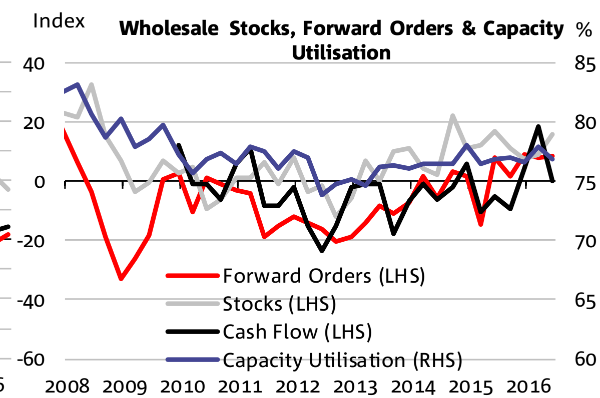
Growth in purchase costs for wholesale is ameliorating



Trading conditions strong, but the recovery in profitability still tentative. Employment conditions relatively subdued still



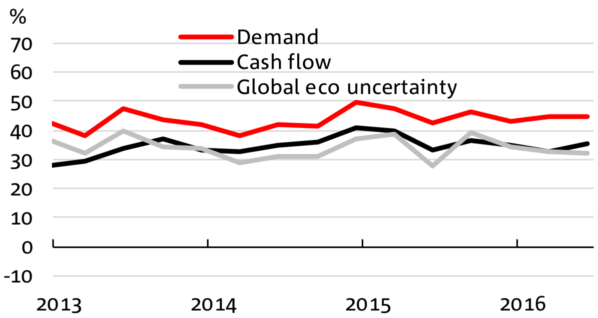
Forward orders and stocks are rising gradually, but capacity utilisation largely stable

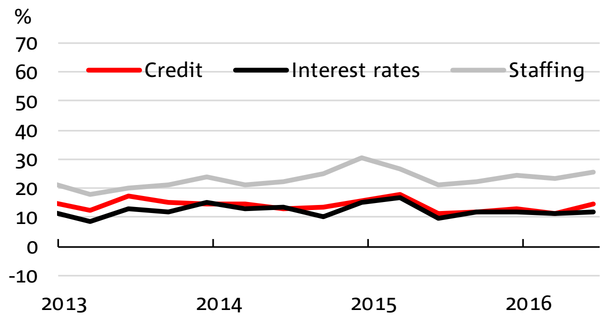


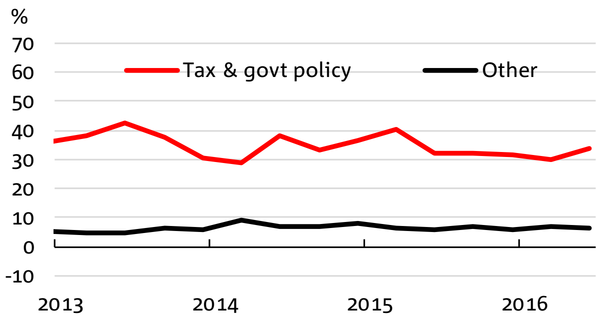
Significant constraints affecting SMEs' long-term decisions mixed in the quarter

- The lead-up to the federal election on 2nd July appeared to have weighed on SMEs' assessment of the significant constraints affecting their long-term decisions. "Tax & government policy" was reported to be a more serious constraint in the quarter, rising by 4 points to +34, although lack of demand continued to be the main constraining factor, followed by cash flow.
- Supply-side factors, including staffing availability, interest rates, as well as credit, continued to be relatively benign overall, although the reported severity of credit as a constraint picked up (up 3 points to +14) in the quarter.

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



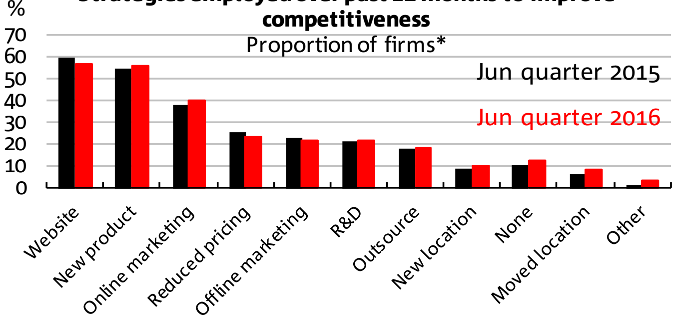




SMEs more reliant on new products, online marketing and relocation to improve their competitiveness

- In the June quarter, we again asked firms whether they had employed any new strategies over the past 12 months to improve their competitiveness in the market.
- Compared with the results in the same quarter in 2015, there had been some changes in a number of strategies undertaken by firms to improve their competitiveness, including more intensive usage of new products, online marketing and relocation. Meanwhile there had been a lesser reliance on website and price reduction as means to improve competitiveness.

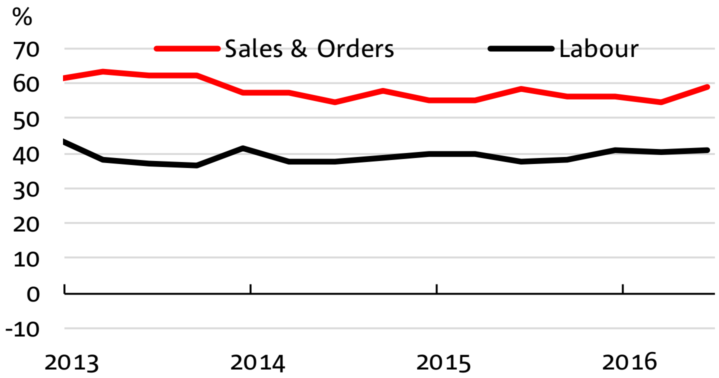
Strategies employed over past 12 months to improve competitiveness

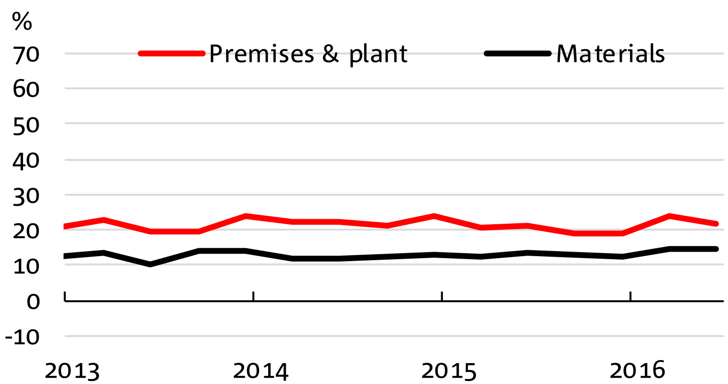


* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

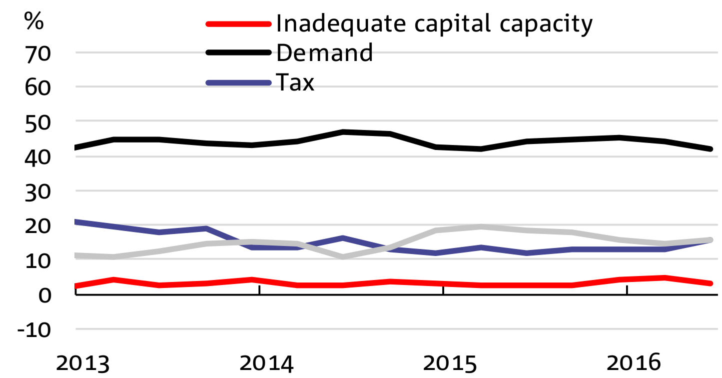
Constraints facing SMEs' output and profitability

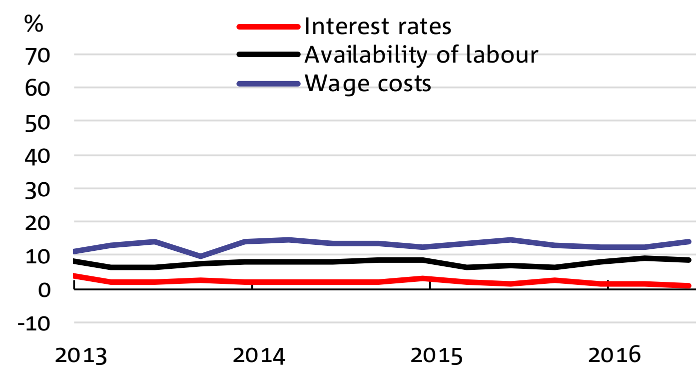
Constraint on output (% of firms)





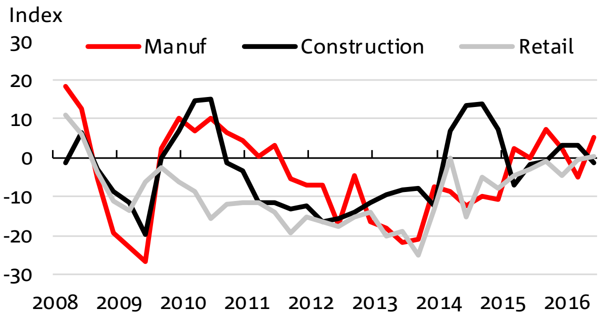
Constraint on profitability (% of firms)

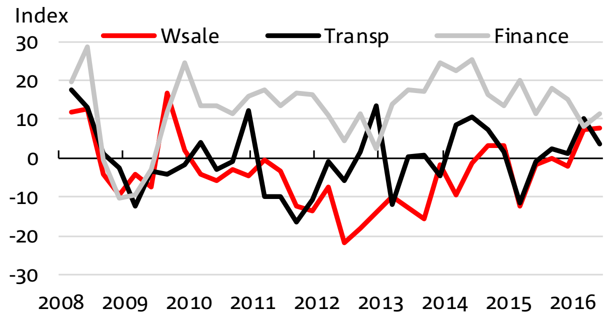


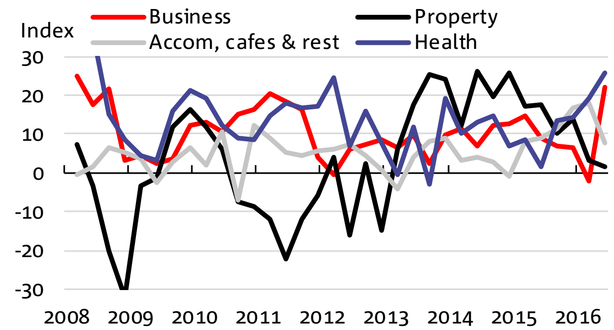


Detail by industry

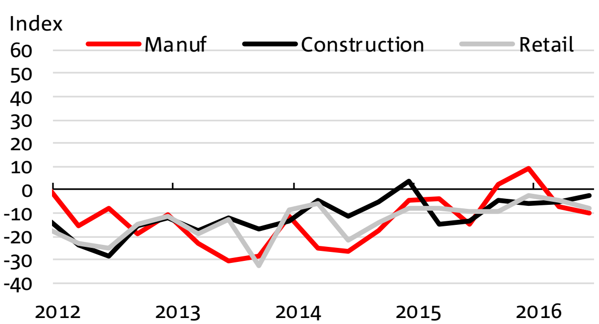
Business conditions by industry (net balance)

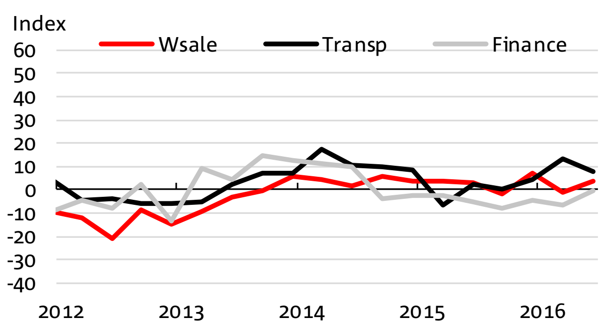


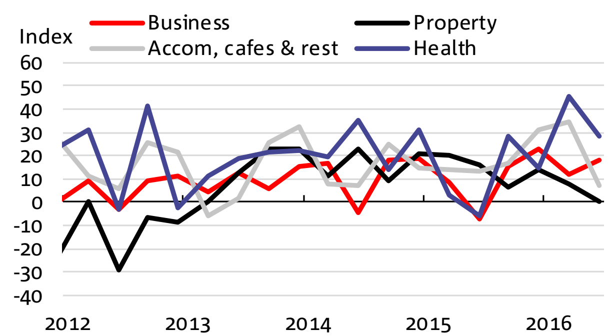




Business confidence by industry (net balance)

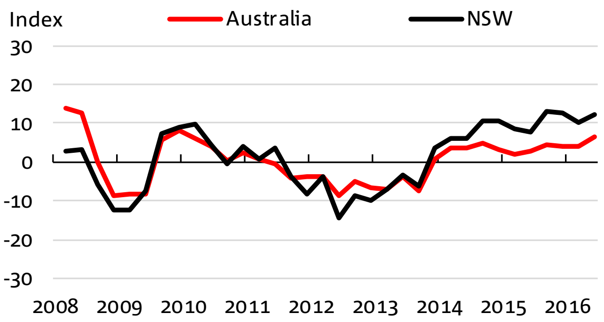


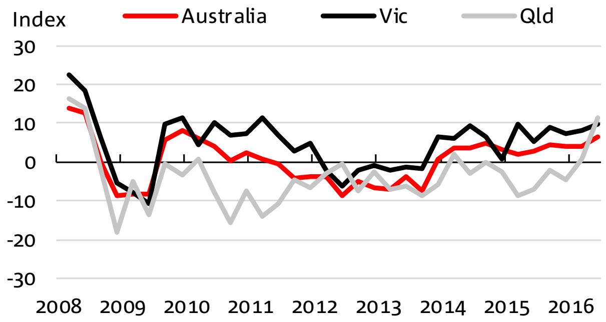


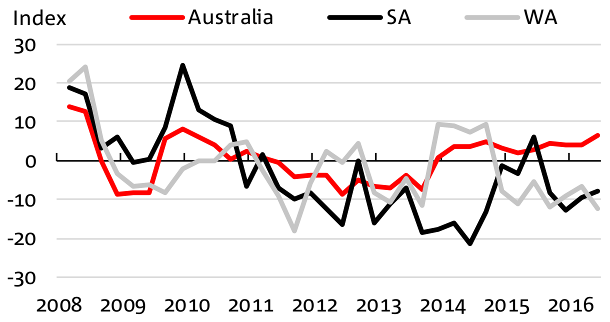


Detail by state

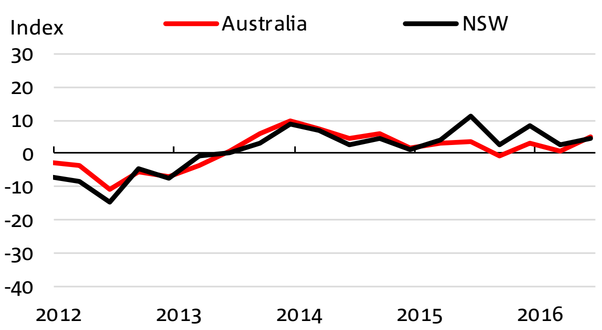
Business conditions by state (net balance)

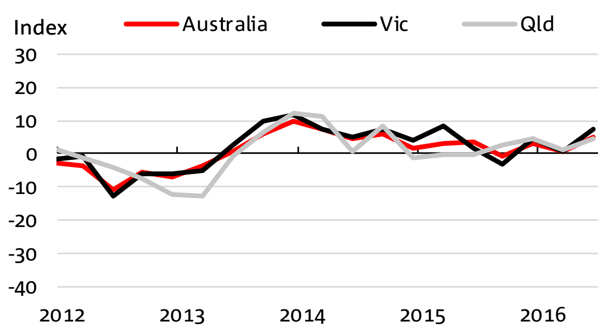


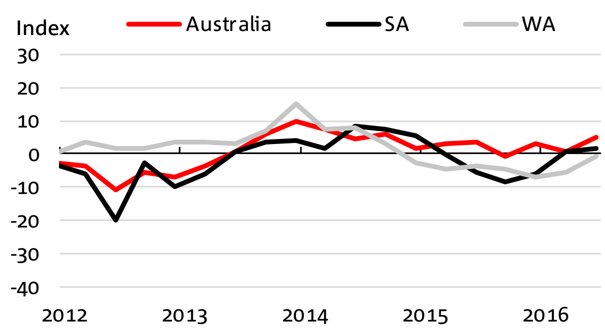




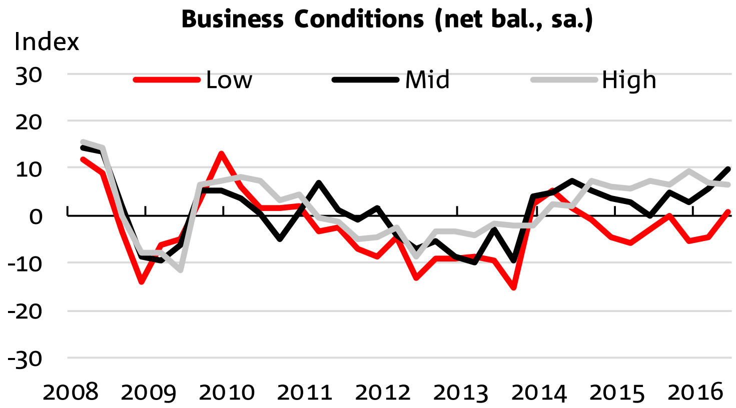
Business confidence by state (net balance)

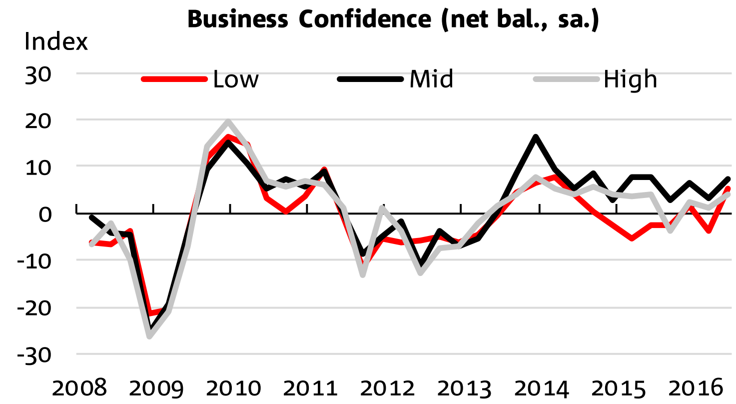


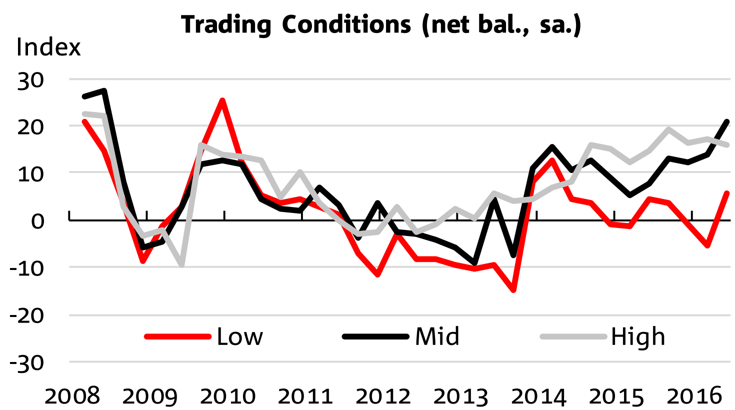


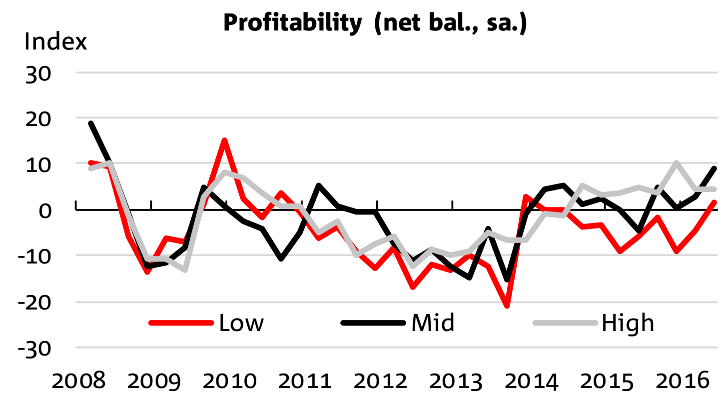


Detail by SME firm size

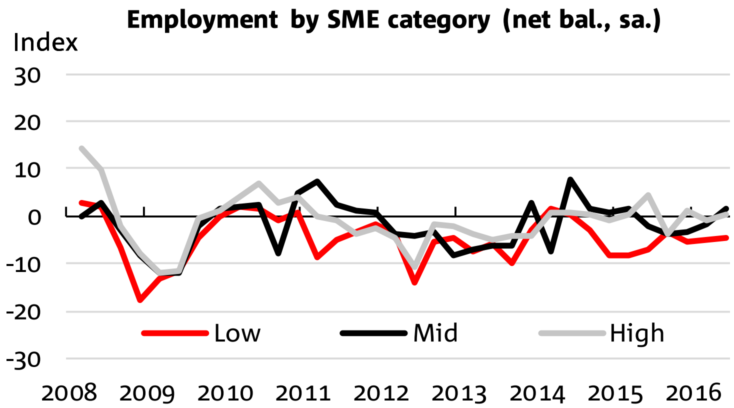


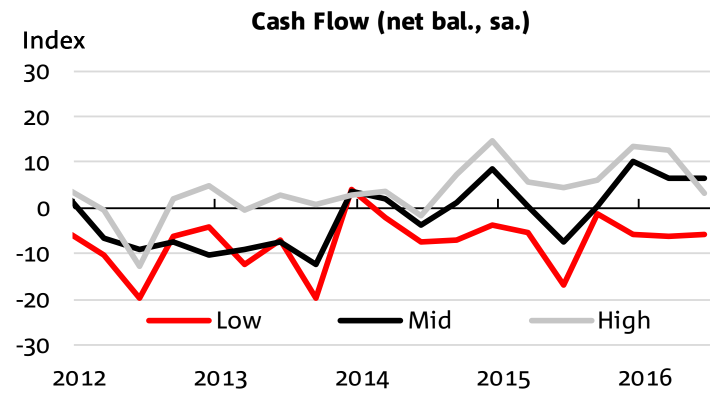


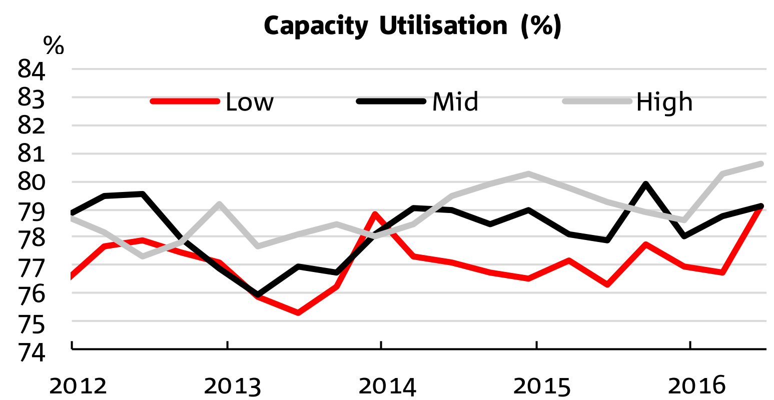


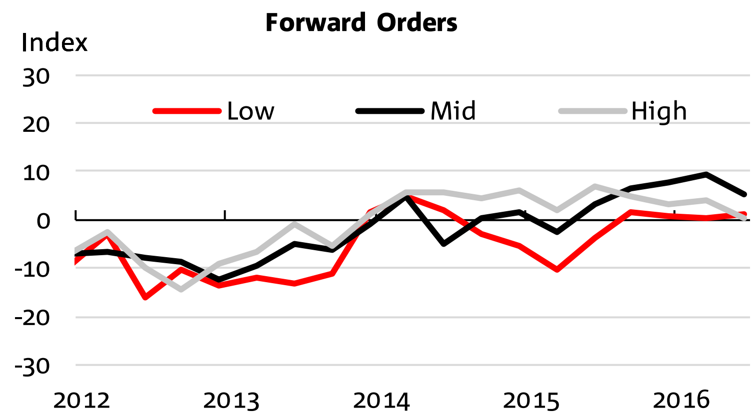


Detail by firm size (cont.)









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