

# NAB QUARTERLY SME SURVEY

SEPTEMBER QTR 2016

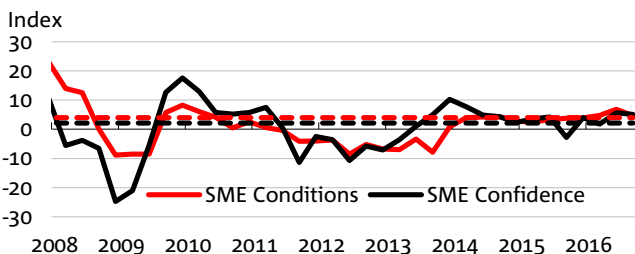


## Key points:

- Despite some moderation in confidence and conditions, the Q3 results from the NAB SME Survey remain reasonably upbeat. Business conditions for SMEs fell by 2 points to +5 index points, but still remain slightly above the long-run average of +4. Encouragingly, low-tier firms reported positive business conditions for the second consecutive quarter.
- In terms of the components that make up business conditions, trading and profitability conditions fell notably, but employment conditions were unchanged, albeit at a weak level. Firms of all size categories reported positive results for trading and profitability conditions in the quarter, although demand for labour by high-tier and low-tier firms remains negative.
- Meanwhile, SME business confidence eased marginally to +5, but stayed comfortably above the long-term average of +2 index points. That said, the fall was in spite of the RBA's 25bps cut to the cash rate in August, perhaps a reflection of the absence of a sustained depreciation in the AUD despite the rate cut.
- By industry, the number of SME sectors which reported positive business conditions fell in the quarter, with transport, retail, manufacturing and accommodation, cafes & restaurants now in negative territory. Similar to Q2, health, finance and business services occupied the top three spots, while transport replaced construction as the weakest sector, followed by retail. Meanwhile, business conditions in wholesale trade managed to hold onto recent gains, a sign that some of the upstream pressures may have ameliorated.
- The results by state were mixed in the quarter. SME business conditions in SA improved further (up 5 points to -2 index points), but remained lacklustre, while the readings for the largest states of NSW and Victoria were relatively unchanged. Somewhat volatile, Queensland gave up all of its gains (10 points) from the previous quarter to be back to +1. Meanwhile, WA continues to be the weakest state in terms of business conditions. Apart from Queensland which recorded an uptick in confidence, all other states reported either no change or a decline in confidence. WA confidence deteriorated the most (down 5 points to -6) to be the weakest of all states.
- Leading indicators were generally resilient, with capacity utilisation remaining at the strongest level since 2011, while capex fell moderately after reaching the highest level since 2007 in the previous quarter. Overall, SME input price indicators, including a further easing in the growth of final prices for retailers, are consistent with relatively contained price pressures.

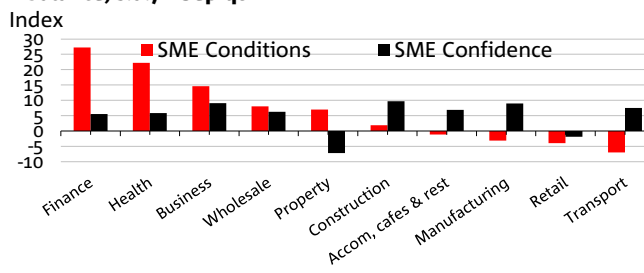
	2015	2016	2016
	Q3	Q2	Q3
<b>Business Conditions</b>	4	7	5
Low-tier firms	-1	1	1
Mid-tier firms	4	10	6
High-tier firms	6	7	6
<b>Business Confidence</b>	-3	6	5
Low-tier firms	-3	5	2
Mid-tier firms	1	8	7
High-tier firms	-5	5	6
<b>Trading Conditions</b>	12	16	11
Low-tier firms	3	5	4
Mid-tier firms	11	21	10
High-tier firms	18	17	18
<b>Profitability</b>	2	6	4
Low-tier firms	-3	2	4
Mid-tier firms	4	9	3
High-tier firms	3	5	3
<b>Employment</b>	-3	-1	-1
Low-tier firms	-3	-5	-4
Mid-tier firms	-5	2	4
High-tier firms	-3	-1	-4

**Table 1: Business conditions & confidence – Sep qtr**

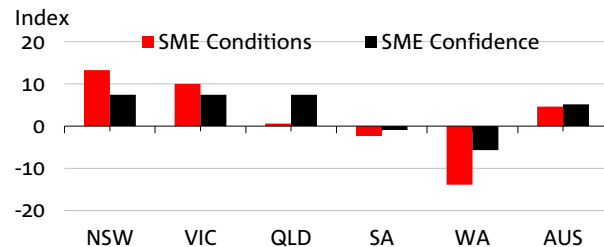


Note: Dotted line denote long-run averages

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



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

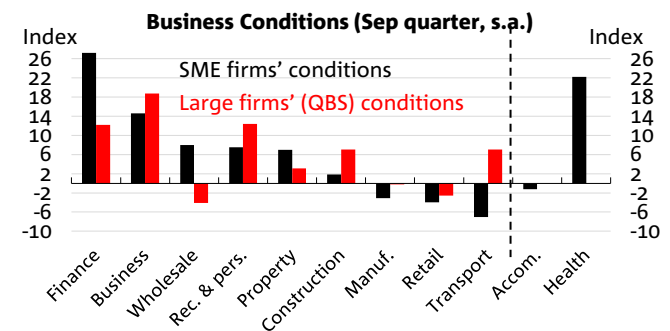
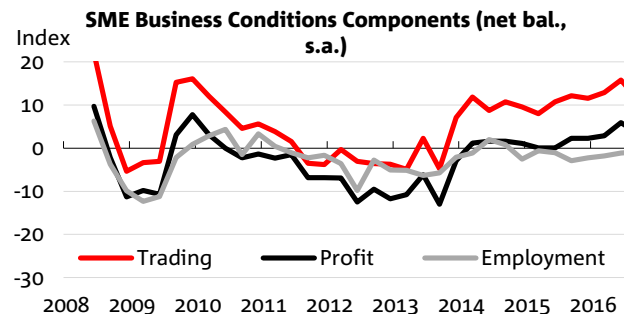
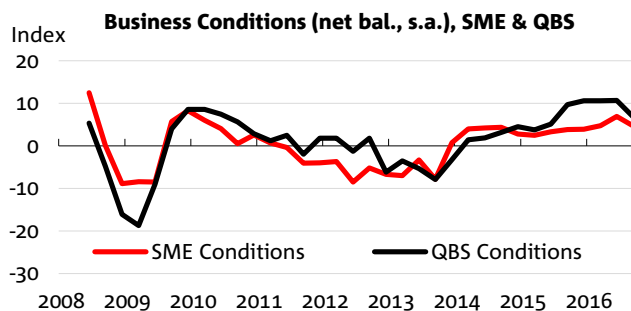


\*\* Data are seasonally adjusted by NAB, except SME cashflow (insufficient time series available). All data are net balance indices. Fieldwork for this Survey conducted from 22 Aug to 8 Sep 2016 covering around 672 SME (non-farm) firms.

# INDUSTRY BUSINESS CONDITIONS & CONFIDENCE

## *Most SME industries reported weaker conditions in the quarter*

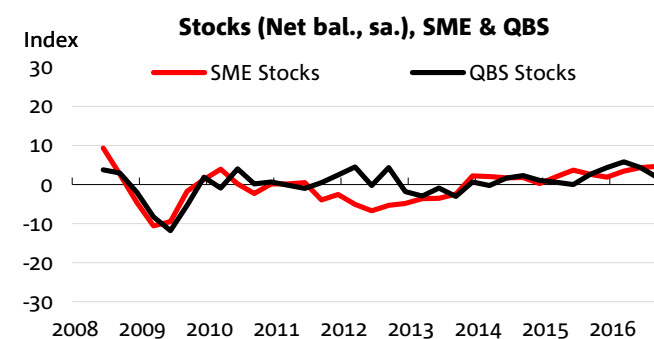
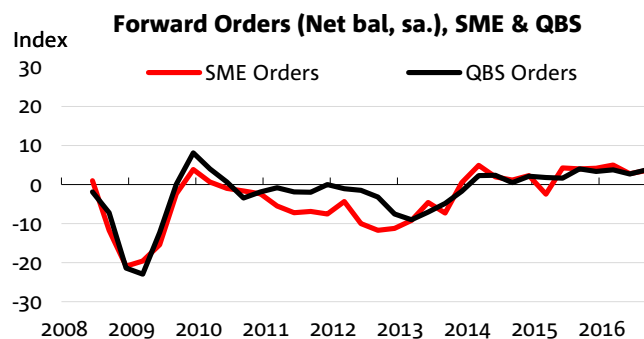
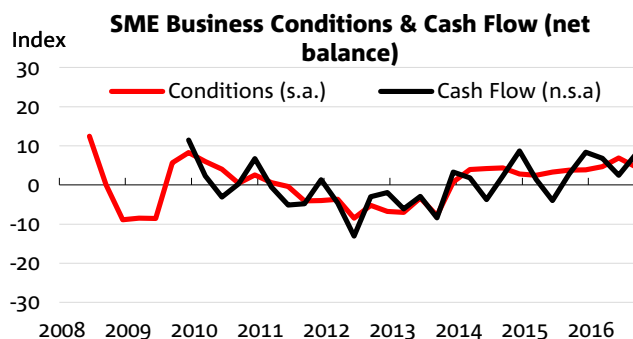
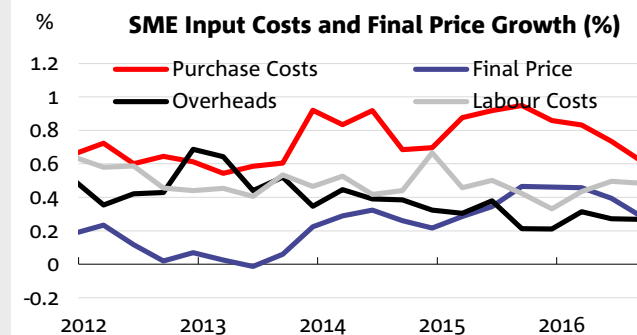
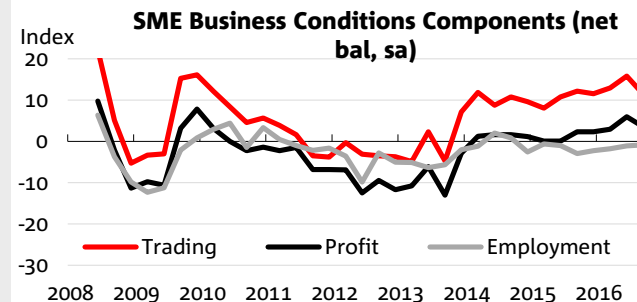
- Business conditions for SMEs eased by 2 points to +5 index points in Q3, but remain slightly above the long-run average of +4. Encouragingly, low-tier SMEs continued to report positive business conditions after recording the first positive reading in two years in Q2 to be around its long-term average. SME conditions are now only marginally below those of general businesses indicated by the NAB Quarterly Business Survey (QBS), but this mostly reflects a notable fall in the conditions of the latter. SME business confidence also eased in the quarter to +5 (from +6 in Q2), but remains above the long-term average of +2.
- Two of the three components that make up SME business conditions fell, with trading conditions (down 5 points to +11) and profitability (down 2 points to +4) both retreating from their recent peaks but continuing to stay above their long-term averages. Despite a sustained period where trading and profitability conditions exceed their historical average, the employment index was in negative territory for the eight consecutive quarter at -1, which was unchanged from the quarter before. The lack of momentum in SME employment conditions are seemingly at odds with the relatively more robust reports by general businesses in the QBS, where the employment index has been tracking above long-term average levels since H2 of 2015. This possibly reflects the weaker financial capacity of SMEs to hire new employees or a greater difficulty for them to find suitable labour compared to their larger counterparts.
- In Q3, business conditions were mixed by state. NSW, Victoria and WA reported relatively stable conditions, SA improved but was still lacklustre, while Queensland deteriorated sharply. The business conditions index for Queensland gave up all its the gains, dropping by 10 points from Q2 to be back at +1 again. The eastern non-mining states of NSW and Victoria continue to outperform at +13 and +10 respectively, while WA remains the weakest of all states at -14. Despite the sharp fall in conditions, Qld was the only state which reported improved confidence in the quarter (up 2 points to +7) to tie with NSW and Victoria in having the strongest confidence. Meanwhile, stronger commodity prices in the quarter had done very little to bolster confidence of SMEs in WA, which reported a decline in confidence (down 5 points to -6) in the quarter to be the weakest of all states.
- Most SME industry sectors reported weaker conditions in the quarter, with services sectors continuing to outperform more traditional sectors in general. Similar to Q2, health, finance and business services occupied the top three spots, while transport (at -7) replaced construction (at +2) as the weakest sector, followed by retail (at -4). The wholesale sector managed to hold onto its recent gains in conditions to be at +8 index points, a sign that perhaps some of the earlier upstream cost pressures had ameliorated. However, weak growth in wholesale final price suggests that competitive pressures downstream are elevated. Business confidence by industry paints a more positive picture overall, with more sectors reporting an improvement rather than a decline in the quarter. Apart from property and retail, all other industries recorded positive confidence. Somewhat surprisingly, confidence of the property sector suffered the sharpest decline in the quarter to be the weakest across industries, even though dwelling prices continue to grow strongly in major markets of Sydney and Melbourne, and more recently, ACT.
- Compared to the larger businesses in the QBS, SME business conditions outperform general businesses in finance, wholesale and property, but are significantly weaker in transport.
- Analysis by firm size shows that low-tier SME firms continue to report weaker conditions and confidence compared to their larger counterparts, although the fact that their conditions and confidence indices are positive remains encouraging.



# FORWARD INDICATORS

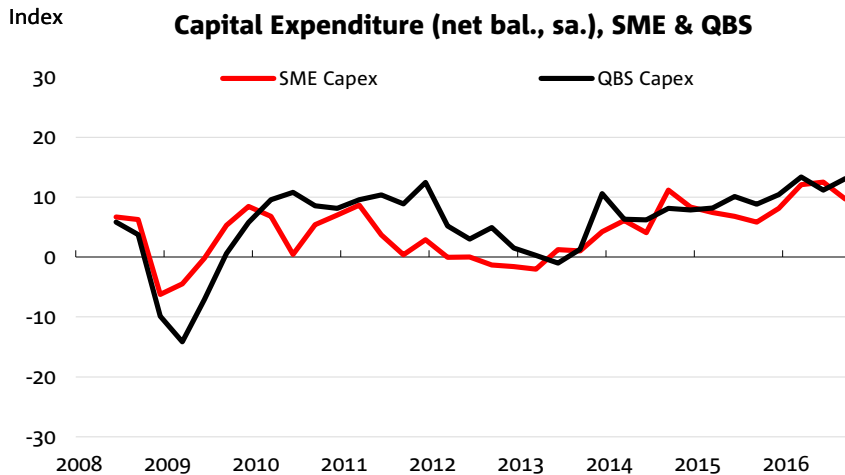
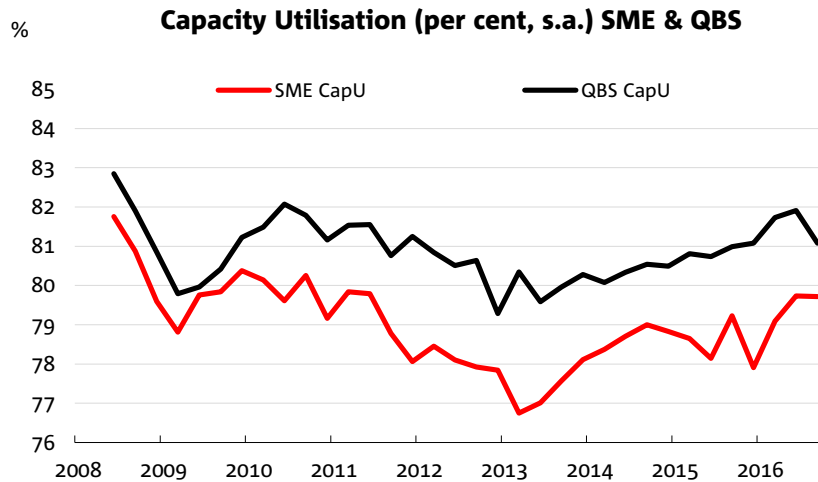
## *Forward and financial indicators suggest a moderate pick-up in activity*

- SME forward orders rose by 1 point to +4 index points in Q3, which is notably above the long-term average of -1 index points and consistent with the result for general businesses as reported in the QBS. The generally positive readings for forward orders since late 2013 are broadly in line with a moderate recovery in real economic activity.
- By industry, the quarterly movements were mixed. Apart from manufacturing, retail and transport, all other industries reported positive forward orders. Forward orders for finance (up 16 points to +17) and health services (up 9 points to +16) jumped by the most in the quarter to record the strongest results, pointing to the continuing outperformance of services sectors. Forward orders for manufacturing fell the most (down 8 points to -1). Meanwhile, transport and retail, both at -3, 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 +5 index points, to be above the long-term average of +2 index points and that of larger businesses indicated by the QBS (at +2). The improvement was largely driven by business services and health, both rising by 6 points to +13 and 0 respectively. The stock index for business services was also the highest in the quarter, followed closely by wholesale (down 6 points to +11). The relatively high stock levels reported by the wholesale sector is consistent with a higher capacity utilisation rate and resilient forward orders in the quarter. That said, the sharp deterioration in the conditions of larger wholesale businesses as indicated by the QBS could signal an imminent weakening of wholesale SMEs in coming quarters. Meanwhile, stocks for manufacturing (down by 11 points to +3) and property services (down 9 points to -7) fell by the most in the quarter, with the latter the weakest across industries. The two consecutive quarterly falls for property services are consistent with a lower transaction volume in the housing market recently.
- The non-seasonally adjusted cash flow index was the strongest in Q3 for financial services (at +24), followed by business services (at +22) and the weakest for transport (-9) and retail (-8).
- Overall, SME price indicators point to relatively contained price pressures. Growth in input costs (purchase costs, overheads and labour costs) have generally eased over the last two years and have contributed to improved margins readings. That said, final price growth appears to have lost some momentum in recent quarters – probably indicative of strong downstream competition – and is consistent with a subdued inflation outlook.



# CAPACITY UTILISATION AND CAPITAL EXPENDITURE

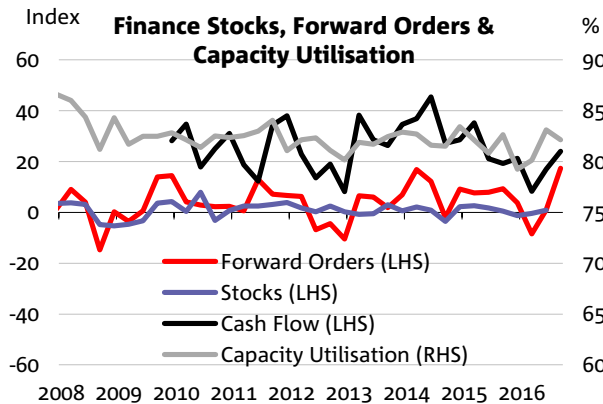
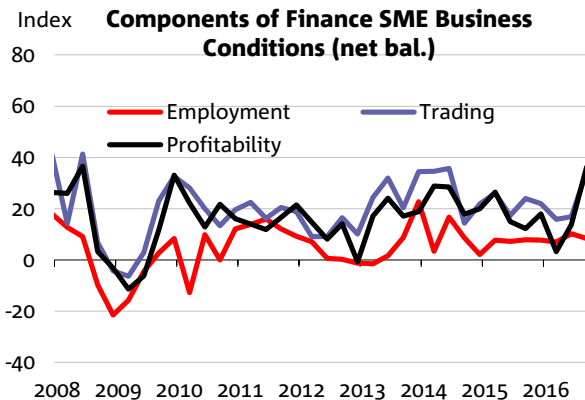
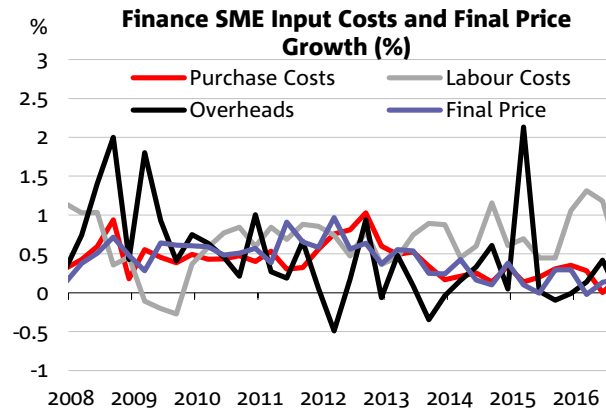
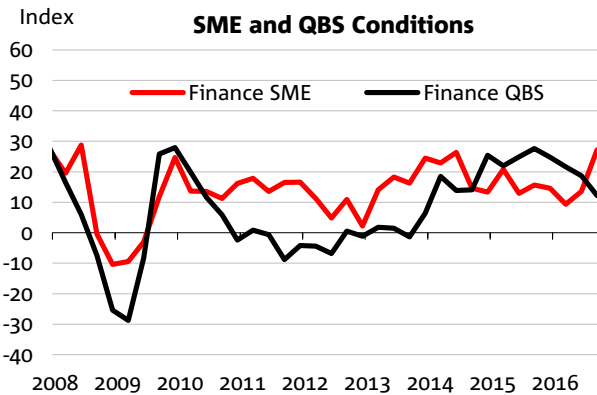
## *SME capacity utilisation and capex stay elevated*



- SME capacity utilisation was unchanged in the quarter at 79.7%, the highest level since late 2011. The sharp fall in the capacity utilisation of general businesses indicated by the QBS has narrowed the gap between the two measures. Most industries reported lower capacity utilisation rates in the quarter, with business services (down 3.2ppts to 82.6%), health (down 3.2ppts to 85.7%) and manufacturing (down 2.8ppts to 74.9%) registering the steepest falls, but they were also the ones that recorded very significant gains in the previous quarter. Despite a fall, health continues to report the highest capacity utilisation across industries but its capacity utilisation is now below the long-term average. Meanwhile, accommodation and manufacturing reported the weakest capacity utilisation at 75.0% and 74.9% respectively.
- Analysis by firm size suggests that the capacity utilisation rate by mid-tier firms (up 1.3ppts to 80.5%) rose notably in Q3 to outperform that of low-tier (down 0.5ppt to 78.5%) and high-tier firms (down 1.0ppt to 79.4%), despite reporting weaker conditions and confidence in the quarter.
- Consistent with a deterioration in trading conditions in the quarter, capital expenditure (capex) by SMEs dipped moderately to +10, to be slightly below the capex reading for larger businesses as indicated by the QBS but still significantly above the long-term average of +6. The rising trajectories of the SME capex and capacity utilisation indices since 2013 are consistent with an improvement in trading conditions corresponding to the depreciation of the AUD and record low interest rates. However, it can be argued that the initial impetus from these factors has probably washed out and a further recovery in the SME sector will be contingent on a pick-up in demand-side factors.
- Longer-term capex intentions also improved, with 12-month capex expectations picking up to +16 in Q3 from +12 in the same quarter last year.
- All industries reported positive capex in the quarter, pointing to a general sense of optimism by SMEs regarding their activity outlook. Looking through the quarterly volatility, capex is trending up in most industries, except for property services and business services which are tracking sideways, as well as financial services and accommodation which demonstrate downward trends. At +18 index points, health had the highest capex reading out of all industries, followed by accommodation, cafes and restaurants at +16. Meanwhile, construction reported the weakest capex reading of +3.

# IN FOCUS: FINANCE

## Finance SMEs' input costs in control, trading and profitability soared



- In the post-GFC period, finance SMEs have been the best performer across industries with an average business conditions reading of +15, followed by health SMEs at +13. Finance SMEs have consistently reported positive business conditions since the GFC, and their performance has been more stable compared to their larger counterparts as covered by the QBS. Based on the top LHS chart, larger finance firms appear to only start experiencing more favourable conditions in late 2013, broadly in line with the recovery in the housing market, while finance SMEs appear to have been less affected by those cyclical factors.
- Given that the operations by finance SMEs are predominantly domestically-oriented, their input costs and final price are not as evidently affected by the movements in the AUD compared to the wholesale or retail sector. Despite them experiencing relatively subdued final price growth since 2012, finance SMEs generally have been able to keep their input cost growth reasonably contained (see top RHS chart). Labour cost growth, despite being stronger than that of other input costs, has also ameliorated in the last two quarters.
- As a result, profitability and trading conditions for finance SMEs improved markedly in Q3, with the former reaching the highest level since 2008. Underpinning the more favourable profitability conditions and forward orders was an uptick in finance SMEs' forward orders and cash flow. Consequently, labour demand (as indicated by the employment index) by finance SMEs has also been significantly stronger than all other industries except for health.
- Generally positive trading and profitability conditions of finance SMEs are also reflected in their consistently high capacity utilisation rate. Meanwhile, the consistently subdued stocks index is perhaps more of a reflection of the lack of physical products in the finance industry.

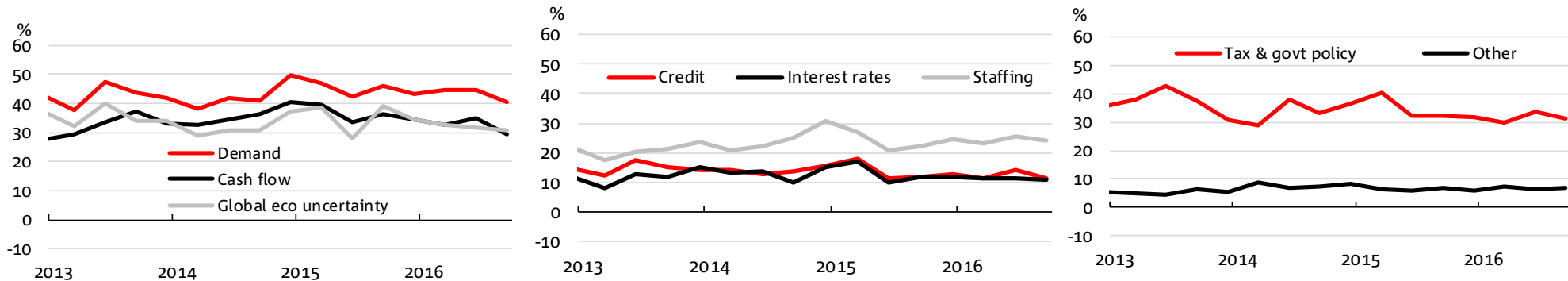


# SIGNIFICANT CONSTRAINTS AND COMPETITIVE STRATEGIES

## *SMEs reported easing constraints from demand and cash flow conditions*

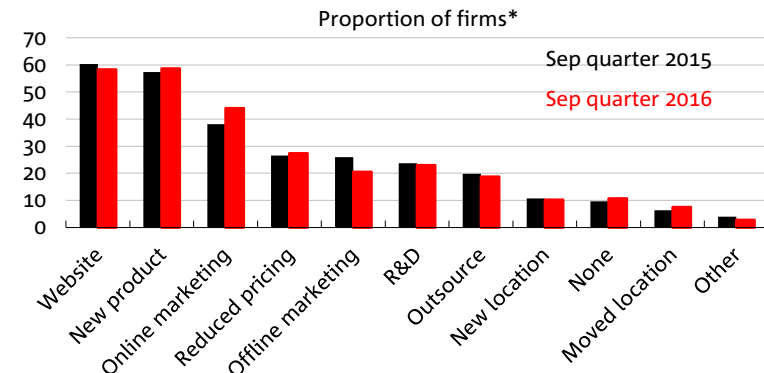
- In Q3, nearly all of the significant constraining factors affecting SMEs' long-term decisions ameliorated. Sustained periods of above-average trading and profitability conditions appear to have eased the severity of (insufficient) demand and cash flow as constraining factors.
- Meanwhile, "Global economic uncertainty" as a constraint also eased in the quarter, likely reflecting the better-than-expected functioning of domestic and global financial markets in the aftermath of the Brexit vote, the continuous recovery in the US and European economies, as well as fewer concerns about a sharp slowdown in China's growth.
- Supply-side factors, including staffing availability, interest rates, as well as credit, continue to be relatively benign overall.

### MOST SIGNIFICANT CONSTRAINING FACTORS FOR SMEs (PER CENT, MULTIPLE RESPONSES)



- In the September 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 a heavier reliance on less resource-intensive strategies such as online marketing, introducing new products, and to a lesser extent, price reduction. Meanwhile, there had been a clear fall in the employment of offline marketing as a strategy to improve competitiveness.

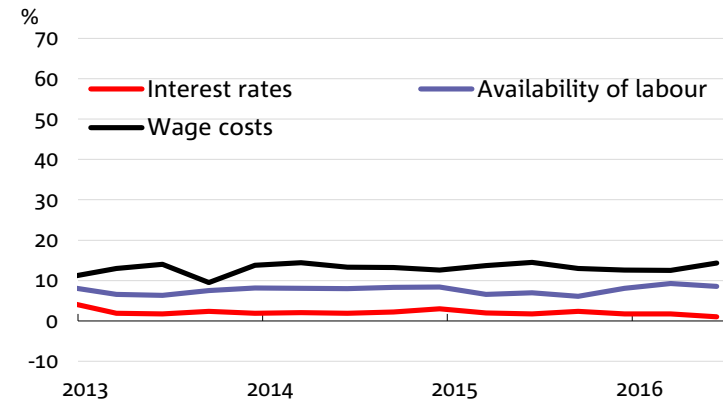
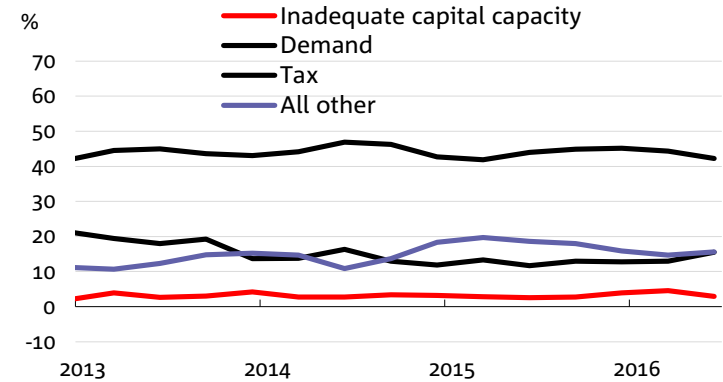
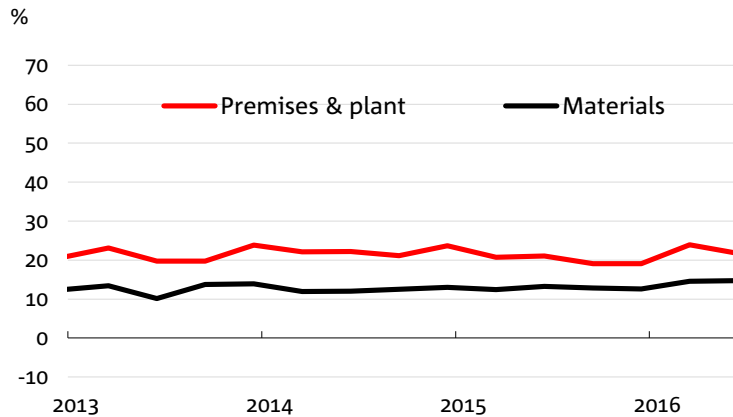
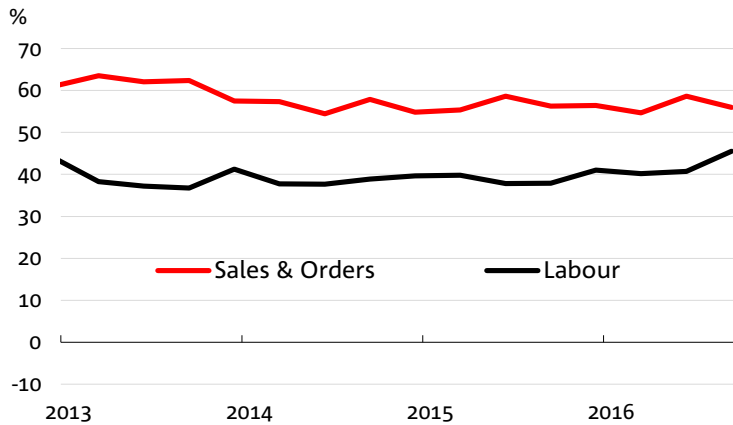
### STRATEGIES EMPLOYED OVER PAST 12 MONTHS TO IMPROVE COMPETITIVENESS



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

# CHARTS

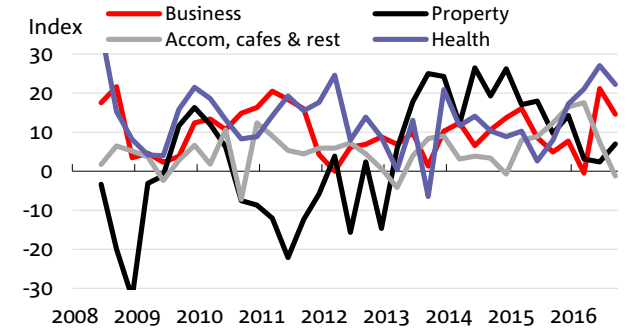
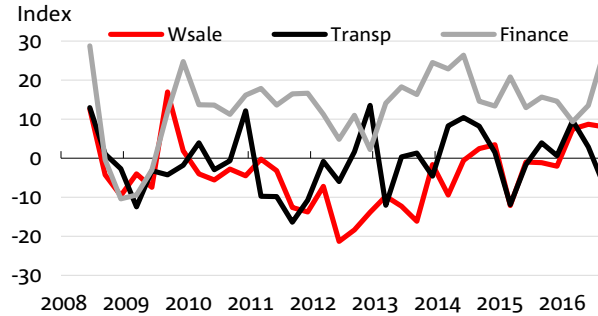
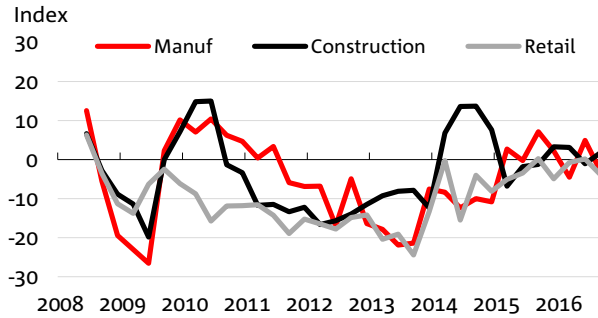
## Constraints facing SMEs' output and profitability



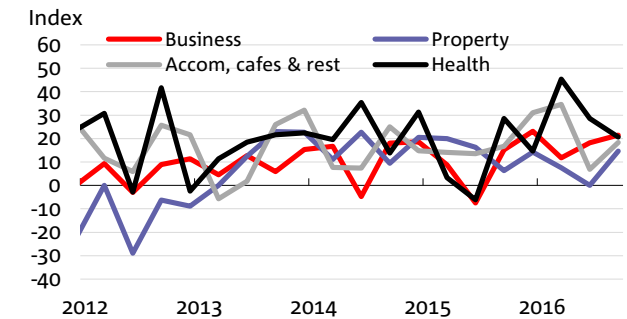
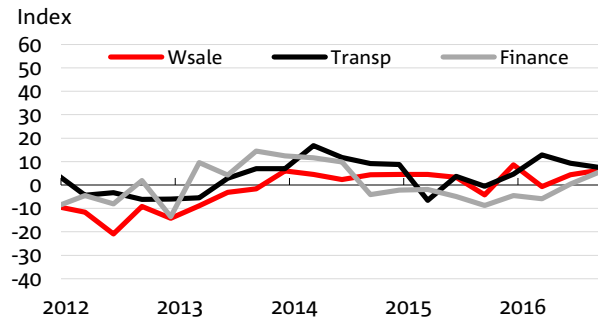
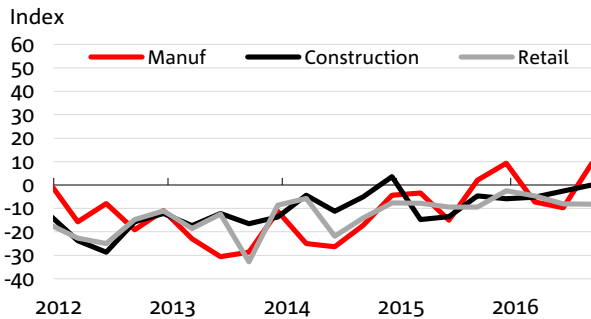
# CHARTS

## *Business conditions and confidence by industry*

### BUSINESS CONDITIONS BY INDUSTRY (NET BALANCE)



### BUSINESS CONFIDENCE BY INDUSTRY (NET BALANCE)

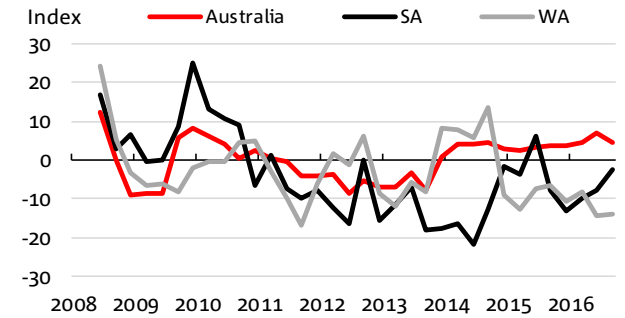
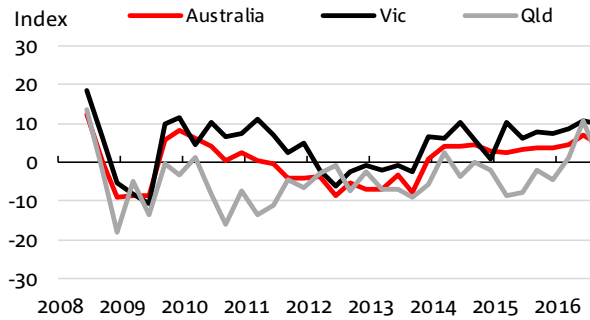
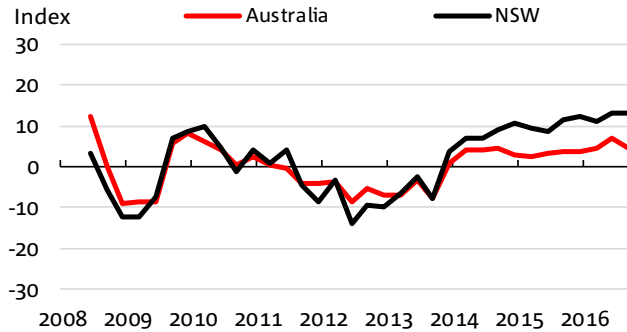




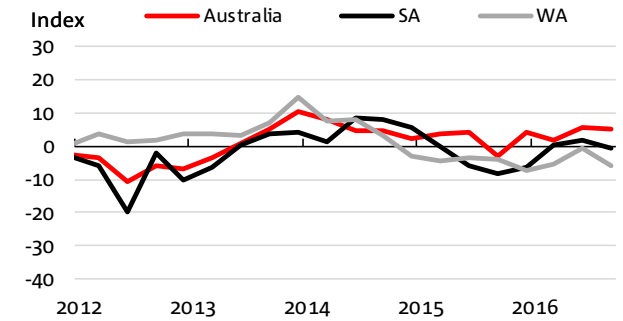
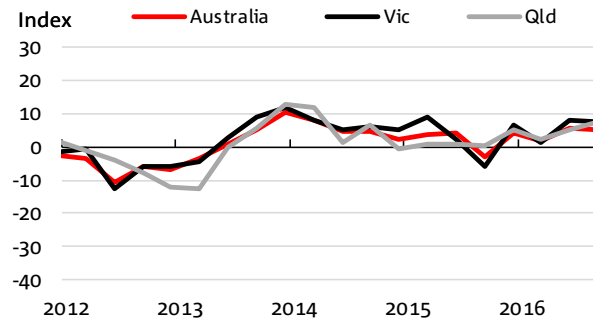
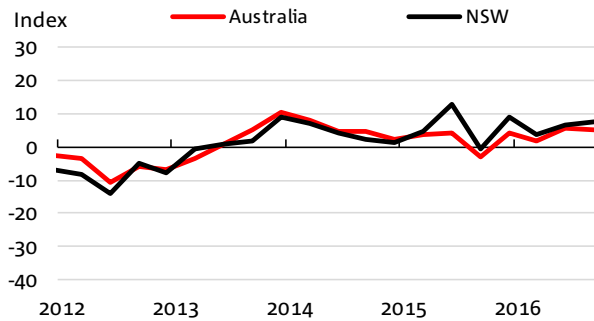
# CHARTS

## *Business conditions and confidence by state*

### BUSINESS CONDITIONS BY STATE (NET BALANCE)

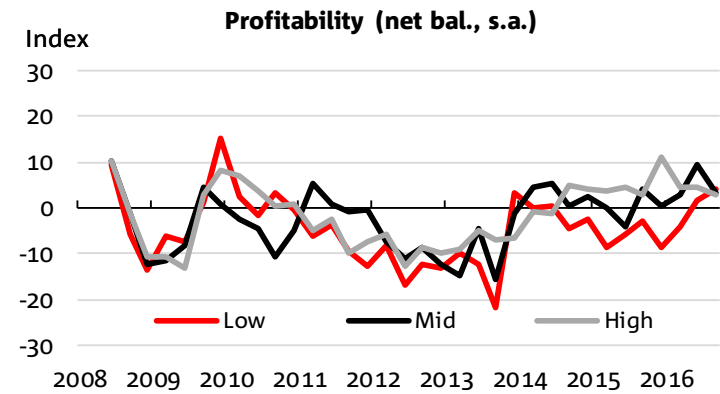
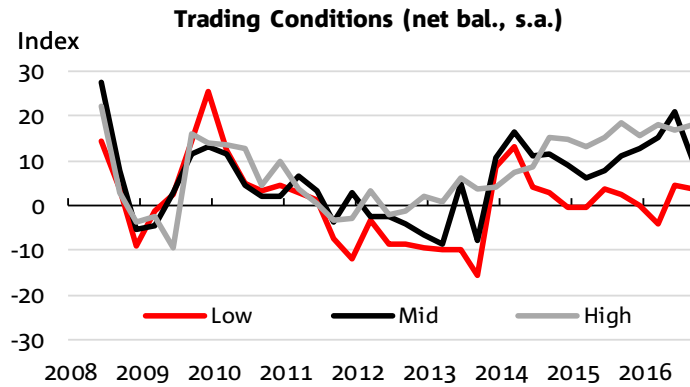
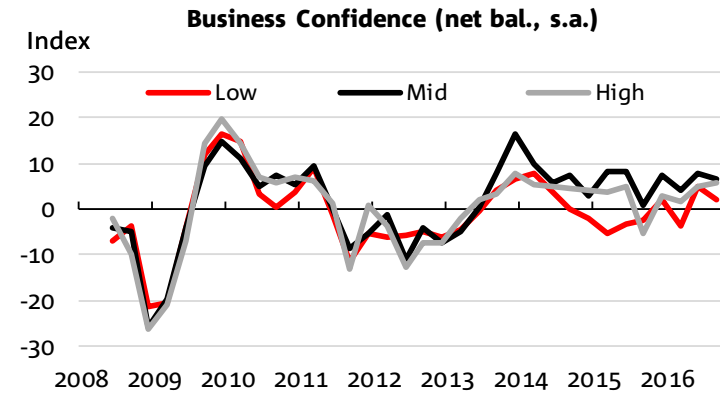
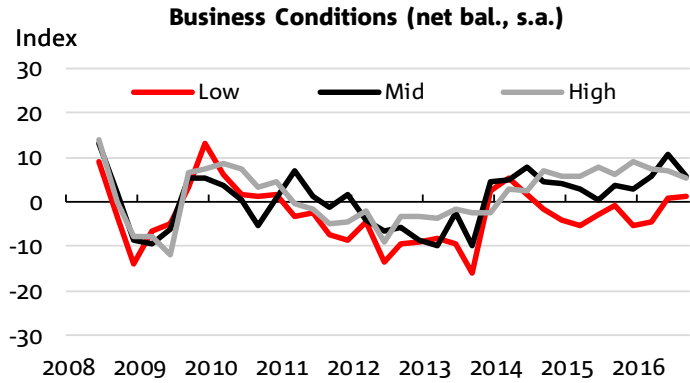


### BUSINESS CONFIDENCE BY STATE (NET BALANCE)



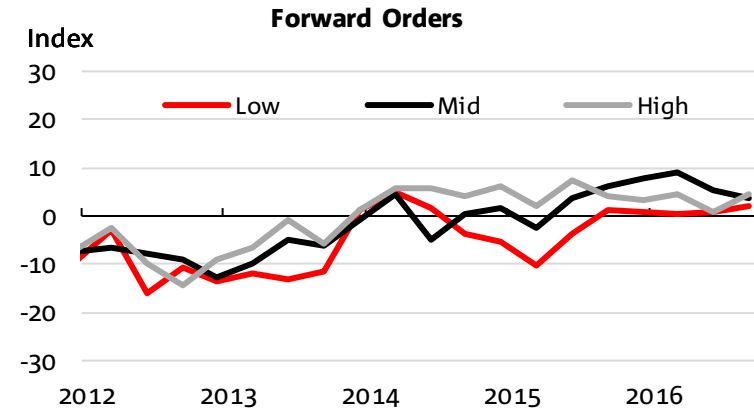
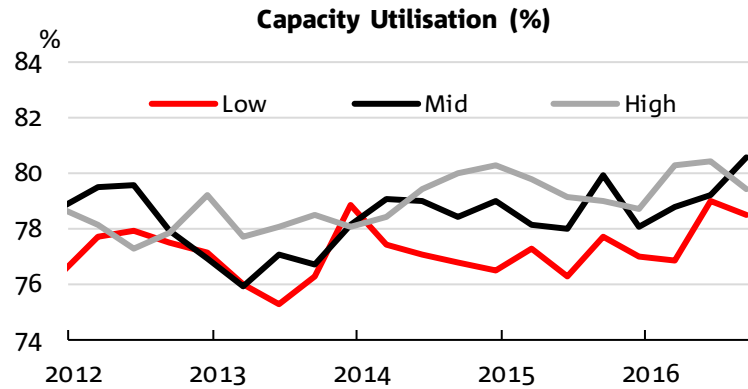
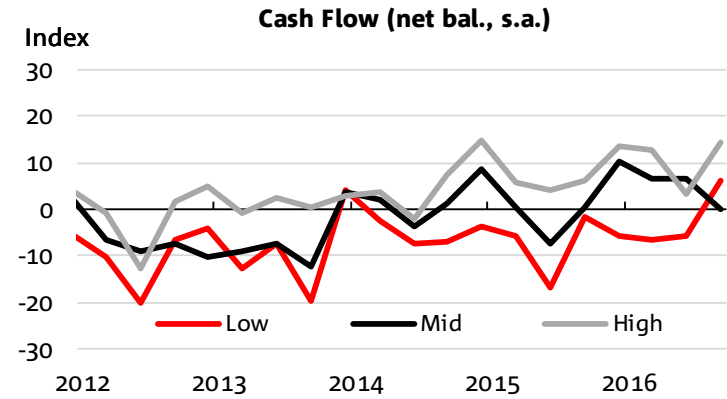
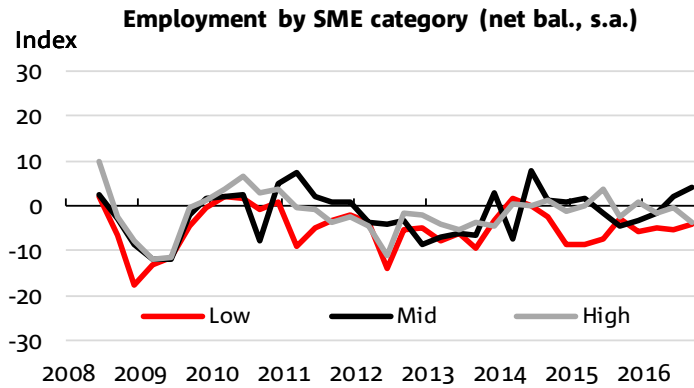
# CHARTS

## Details by firm size



# CHARTS

## Details by firm size (con't)



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