

NAB QUARTERLY SME SURVEY

SEPTEMBER 2017

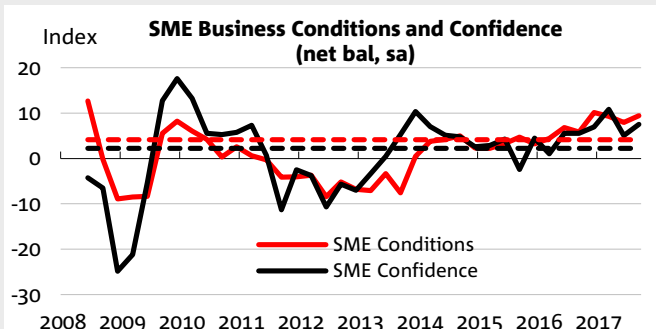


Key points:

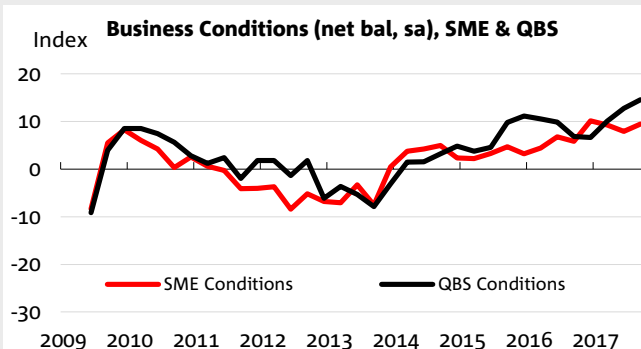
- The NAB Small and Medium Enterprises (SME) Business Survey showed an **improvement in both business conditions and confidence** in Q3. Business conditions have recovered from the small dip in Q2, while confidence bounced back strongly although remained below its high in Q1 2017. Both business conditions and business confidence are above their averages since the survey started in 2006.
- There was, however, **divergence in performance across firm sizes**. While high tier SMEs reported healthy levels of trading, profitability and employment, low tier SMEs were seeing positive trading conditions but weak profitability and employment. Employment conditions at the smallest SMEs have been depressed for some time. Nonetheless, the smallest SMEs remained upbeat, reporting a strong increase in business confidence.
- **An increasing proportion of firms identified the availability of suitable labour as a concern, along with sales & orders**. As the labour market improves and the unemployment rate continues to decline, finding the right skills might be getting more difficult. Labour cost growth has increased strongly this quarter. Along with rising input cost growth and limited final price growth, **margins were squeezed**.
- Despite these constraints, SME firms remained upbeat, with business confidence surpassing that at larger businesses in the NAB Quarterly Business Survey (QBS). **Leading indicators were mixed**. Capacity utilisation fell in the quarter but was up from a year ago. Forward orders, stock levels and capital expenditure intentions all rose. Cash flow also rose strongly.
- **Across states**, Victoria reported the highest levels of business conditions and confidence. Business conditions improved the most in QLD during the quarter but fell in NSW, SA and WA. More encouragingly, business confidence rose across the board. WA has been reporting improving business confidence and it will be interesting to see when (and if) that translates into improvements in WA business conditions.
- The health sector again reported the strongest business conditions **across industries**. Other services industries including property, finance, wholesale and business services also outperformed. At the bottom end of the scale was the retail sector, which has been struggling with depressed business conditions for some years. Meanwhile, the resilience of manufacturing was surprising in the face of car plant closures and an elevated AUD, a result also observed in the QBS.

	2017	2017	2017
	q1	q2	q3
Business Confidence	11	5	8
Low-tier firms	10	-4	8
Mid-tier firms	10	6	5
High-tier firms	12	9	10
Business Conditions	9	8	9
Low-tier firms	6	3	1
Mid-tier firms	9	9	8
High-tier firms	12	10	14
Trading Conditions	17	15	17
Low-tier firms	10	5	7
Mid-tier firms	19	18	18
High-tier firms	19	19	20
Profitability	9	6	9
Low-tier firms	8	3	1
Mid-tier firms	8	7	7
High-tier firms	9	8	14
Employment	2	2	1
Low-tier firms	0	0	-5
Mid-tier firms	-1	1	-1
High-tier firms	5	5	5

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



Note: Dotted line denote long-run averages



CONTACTS

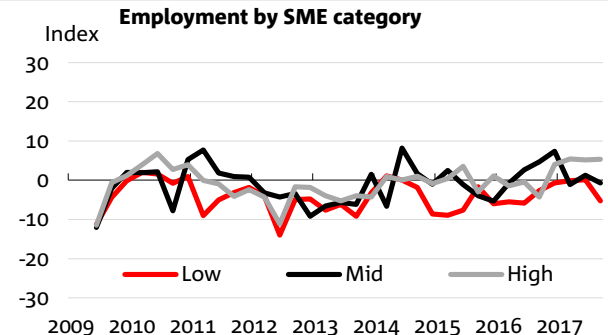
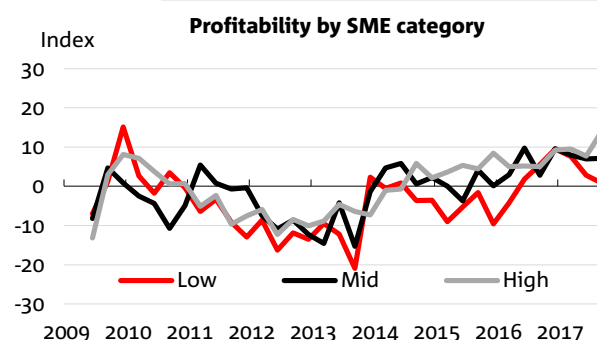
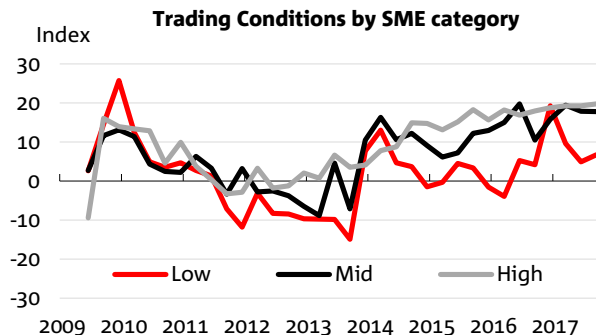
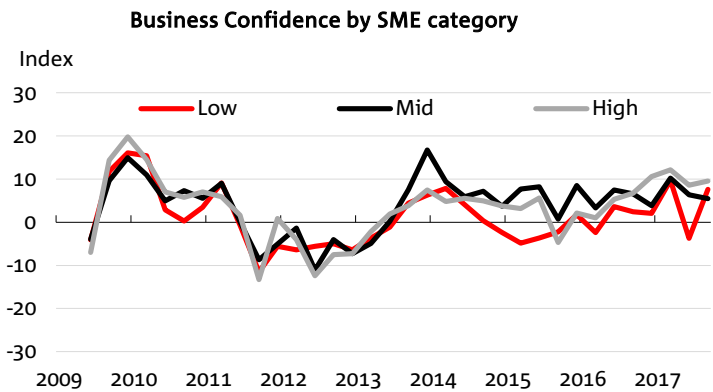
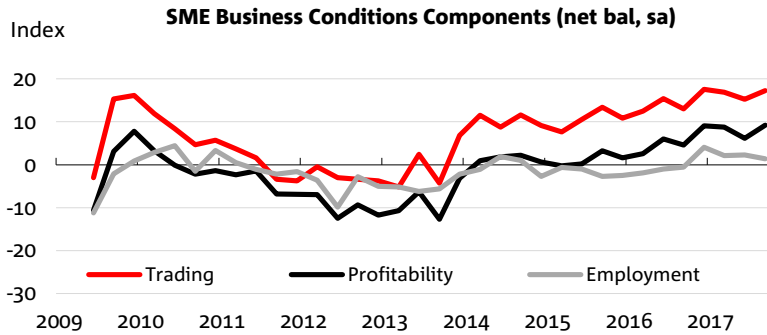
Alan Oster, Chief Economist,
 +61 3 8634 2927

Riki Polygenis, Head of Australian
 Economics, +61 475 986 285

Amy Li, Economist, +61 3 8634 1563

CONDITIONS & CONFIDENCE BY FIRM SIZE

The smallest SMEs doing it tough while remaining optimistic



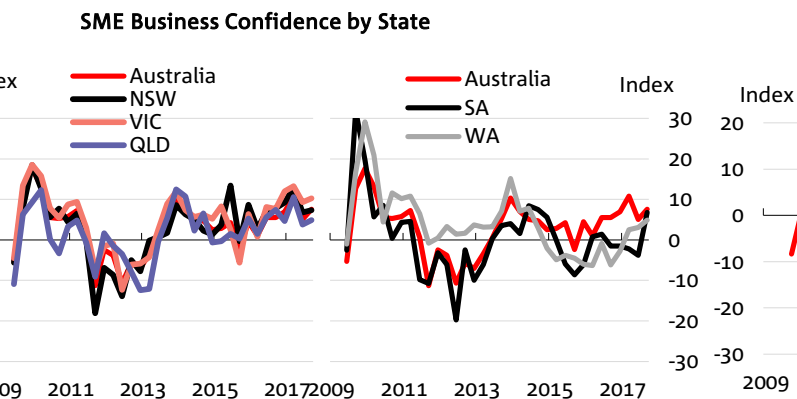
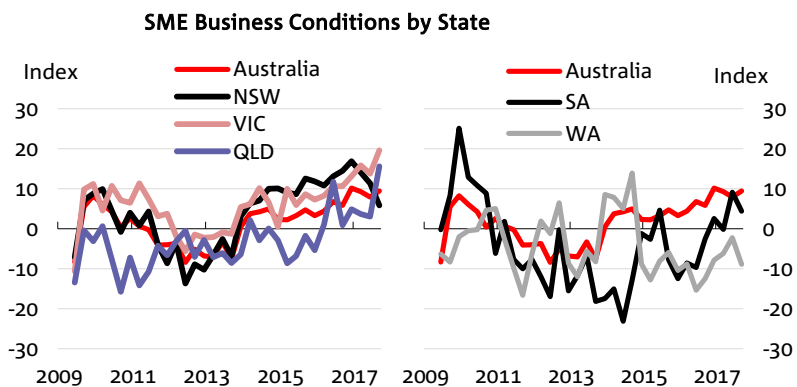
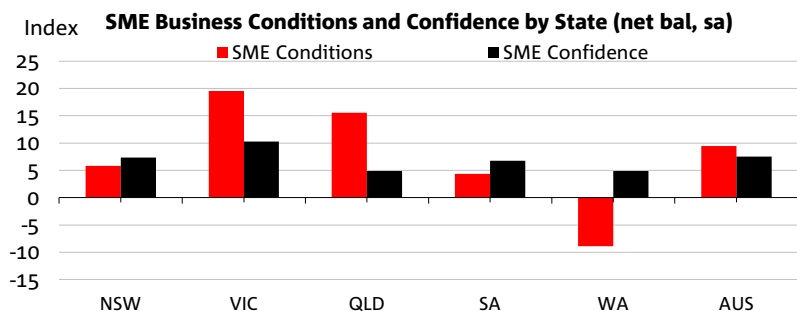
- **SME business conditions** improved slightly in Q3 to +9 index points from +8 in Q2. Business conditions have held in a range of +8 to +9 index points for the past three quarters – down marginally from the peak of +10 index points in Q4 2016, but well above the series average of +4 index points since 2006. The trading and profitability components of business conditions improved in Q3, while employment conditions worsened slightly.
- The increase in conditions in Q3 was driven by improvements at the largest SMEs (turnover between \$5 and \$10 million p.a.). Conditions at low tier firms meanwhile continued to worsen from the Q4 2016 high of +8 index points to +1 index points (see chart on page 8). Conditions for mid-tier firms also edged down to +8 but have only eased a little in recent quarters.
- Looking at the three components of business conditions, **trading conditions** remained the highest. Both high and mid tier firms enjoyed healthy trading conditions, at nearly +20 points. Trading at low tier firms has been more volatile, but improved in Q3, to be at +7, also a very positive reading. **Profitability** showed strong improvement at high tier firms, reaching +14, the highest since the GFC. Profitability was unchanged at +7 at mid tier firms while declining to +1 from +3 at low tier firms. **Employment** was steady at top tier firms, while declining at mid and low tier firms. Employment conditions have been negative at the smallest SMEs for some time, which is of concern. As these firms battle with volatile trading conditions and profitability, their hiring needs have remained more depressed. In contrast, an employment conditions reading of +5 at top tier firms indicates increases in hiring.
- SME Business confidence rebounded to +8 from +5 in Q2, although remains below the recent peak of +11 in Q1. Despite the weakening in conditions at the low tier firms, their **confidence** surged during the quarter, to +8 points from -4. Top and mid tier firms' business confidence was largely stable at around +10 and +6 points, suggesting a positive outlook. The largest SMEs now enjoy the highest level of business **confidence** as well as conditions.

Note:

- 1. Business conditions are the average of three indices on trading, profitability and employment;
- 2. Low-tier firm: turnover \$2 – 3m p.a.; Mid-tier: \$3 – 5m. High-tier: \$5 – 10m

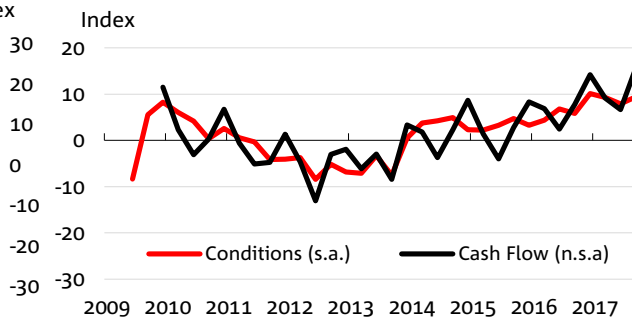
CONDITIONS AND CONFIDENCE BY STATE

Victoria again leads in business conditions and confidence

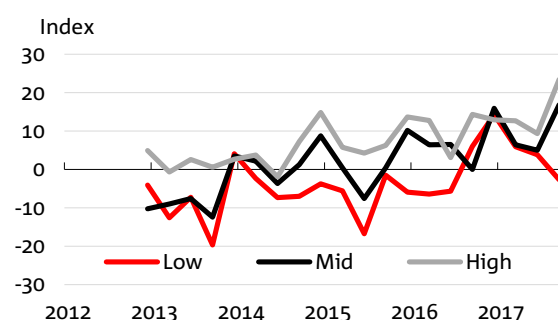


- Victorian SMEs reported the highest business conditions and confidence in Q3 across all states, a result that has been consistent this year and reflected the state's economic outperformance. Victorian **business conditions** rose +6 points to +20, to record the highest conditions reading across the states for the third consecutive quarter, after surpassing New South Wales in Q1 2017. Victorian business confidence also increased to +10 points following a drop to +9 in Q2.
- Business conditions improved the most in QLD during the quarter, rising +13 points to +16. In contrast, conditions fell in NSW, SA and WA. It was the third quarterly fall in conditions in NSW, down to +6 points, albeit still quite a positive reading. South Australian business conditions were at +4 points while WA conditions have been fluctuating in negative territory for some time, now at -9 points, indicating a contraction.
- More encouragingly, **business confidence** rose across the board. The biggest improvement was in SA, where confidence rose +11 points to +7 from a negative -4. The sample size for SA was smaller however, so the results should be read with caution. Confidence also improved again in WA, the fourth consecutive quarterly increase after some negative readings last year. It will be interesting to see when the improved sentiment will translate to positive business conditions in WA. The three biggest Eastern states also enjoyed small increases in business confidence, overall a positive sign.
- **Cash flow** has increased strongly with better business conditions. The increase was driven by mid and high tier firms while cash flow declined at low tier firms, another concerning result consistent with falling profitability and employment conditions at the smallest SMEs.

SME Business Conditions & Cash flow

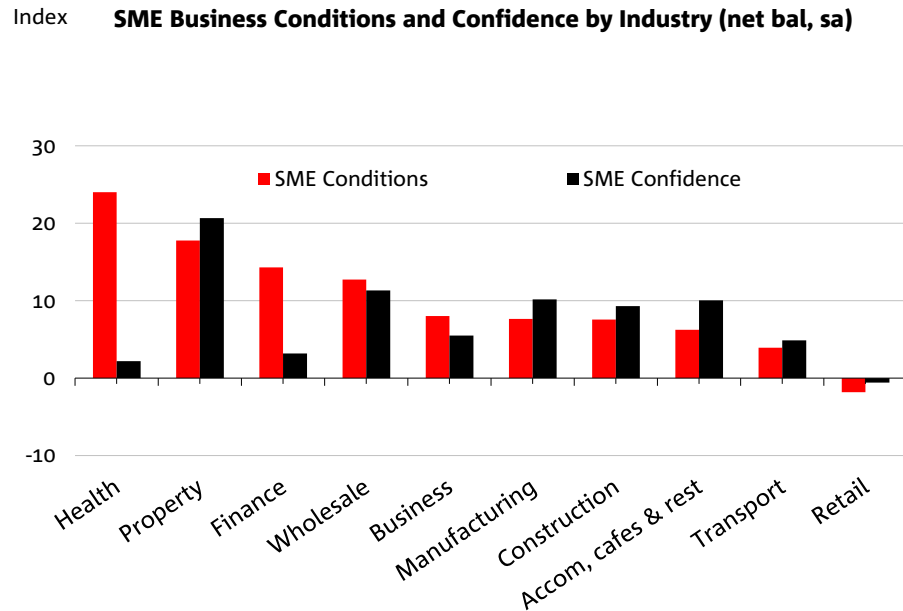


Cash flow by firm size

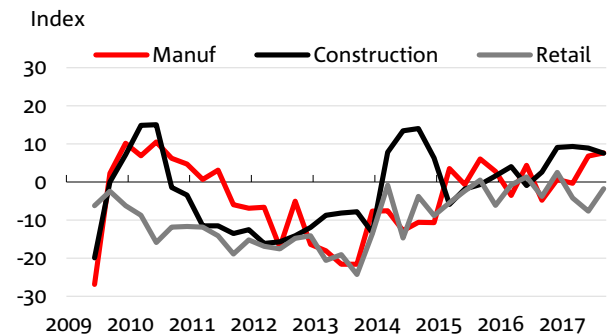
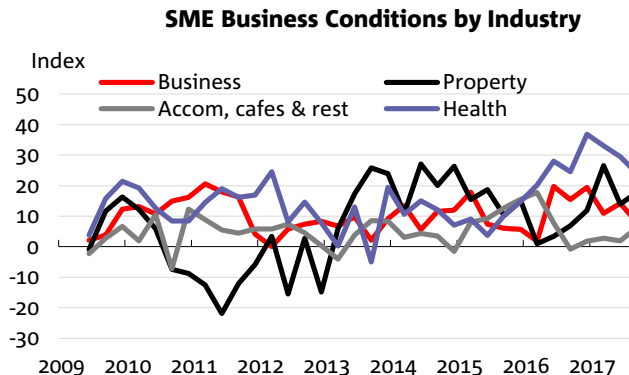
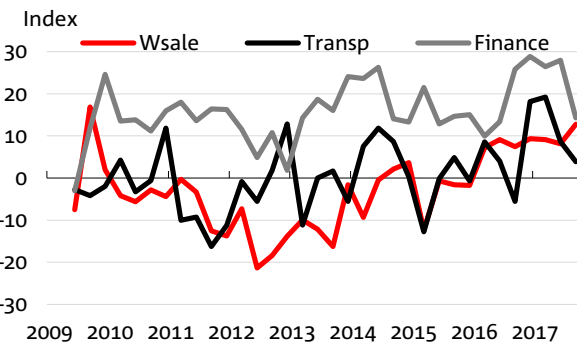


CONDITIONS AND CONFIDENCE BY INDUSTRY

Health continued to lead in business conditions, but confidence dropped

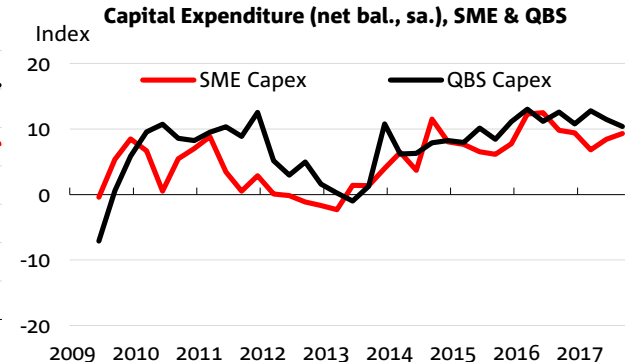
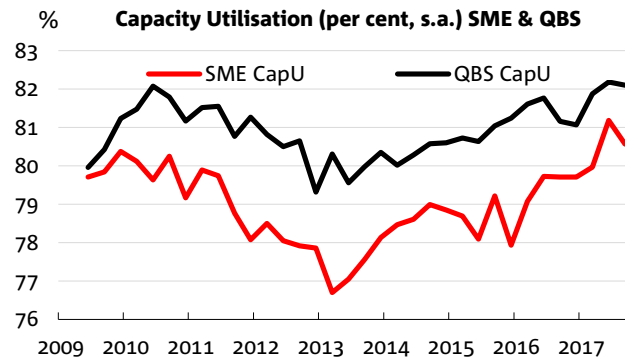
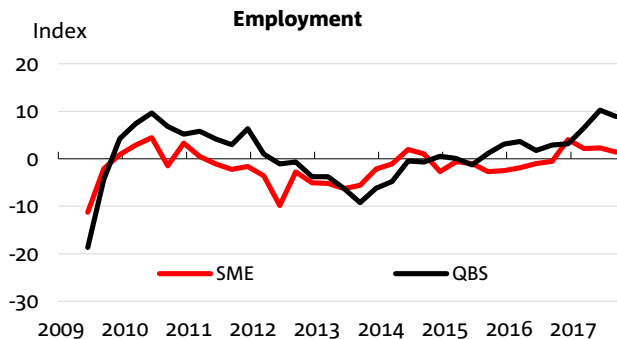
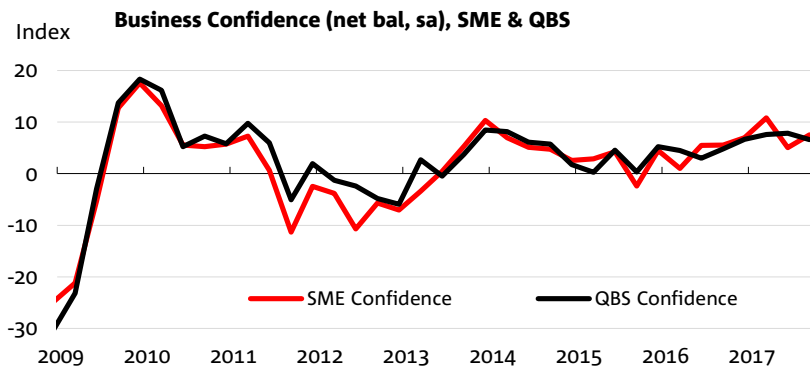
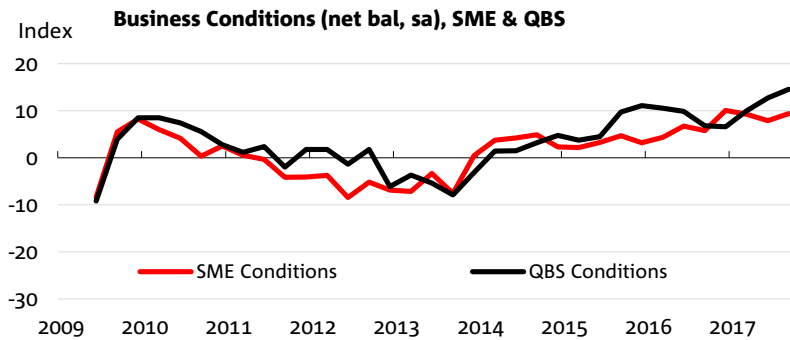


- Across industries, health again reported the strongest **business conditions** in Q3. Other services industries including property, finance, wholesale and business services also outperformed. At the bottom end of the scale was retail, who has been struggling with negative business conditions for some years.
- Conditions fell during the quarter in the better performing industries, including a sharp fall in finance, transport and health, while improving in wholesale, property, hospitality and the struggling retail industry. It narrowed the gap between the best and worst performing industries, to a 26 point difference (between health's +24 and retail's -2 points) from a 37 point difference in Q2 (health +29 and retail -8).
- The property sector was the most upbeat this quarter, reporting the highest **business confidence**, followed by wholesale, manufacturing and accommodation cafes & restaurants. The increase in manufacturing SME confidence was somewhat surprising, given the imminent car plants closures when the survey was conducted and the elevated level of the Australian dollar. (The exchange rate averaged \$US 0.79 when the survey was conducted, almost 5 cents high than the average seen during the Q2 survey). Similar improvements in manufacturing were also observed in the QBS, suggesting other parts of the manufacturing industry might be providing offsets. A big decline in health business confidence, despite continually positive conditions, was also hard to explain. Perhaps health business owners are a more pessimistic demographic, consistently reporting downbeat business confidence despite strong conditions (more details on page 8).
- Retail was the only industry with both negative conditions and confidence. The industry faces numerous challenges at present, including tough competition, subdued demand and other structural changes.
- For more industry details, see page 8.



COMPARISON WITH LARGER BUSINESSES

SME conditions lagged while confidence overtook larger businesses

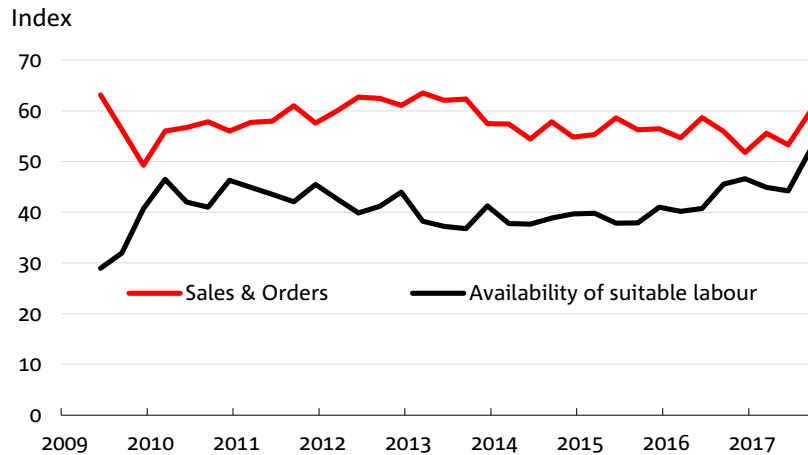


- Both conditions and confidence improved for SMEs in Q3, while conditions for larger businesses reported in NAB's Quarterly Business Survey (QBS) rose but confidence fell slightly. This saw **SME conditions lagging behind larger business conditions while confidence overtook**.
- Looking deeper into the components of business conditions (trading, profitability and employment), trading conditions have been largely similar in the SME and QBS surveys, while SMEs tend to face lower profitability and more subdued employment conditions (more details on page 12). What is somewhat concerning is the weakening in employment conditions at SMEs, at a time when larger businesses are reporting stronger hiring intentions. The weakness was largely driven by the low and mid tier SMEs, whereas larger SMEs reported positive employment conditions. A reading of +1 point was still above the long-run average of zero for SME employment conditions, indicating a small expansion in its work force. The overall improvement in the labour market should see SME employment conditions improve along with QBS. However there has been an increasing proportion of SMEs identifying the availability of suitable labour as an issue. Perhaps that indicates that subdued employment conditions are at least in part a result of supply, rather than demand. That is, a larger share of SMEs might wish to increase hiring but struggle to find workers with the right skills. That theory is consistent with a rise in labour cost growth in the quarter, to 0.8% q/q from 0.4% in Q2. This could present further challenges to profitability. Sales margins growth also remained negative.
- **Leading indicators were mixed.** Capacity utilisation fell during the quarter but was up from a year ago. Forward orders, stock levels and capital expenditure intentions all rose, consistent with the improvements in business conditions and confidence. In contrast, the equivalent QBS leading indicators eased, while still suggesting continued expansion in the next 12 months.
- For more details, see page 12.

CONSTRAINTS ON OUTPUT AND PRICE MEASURES

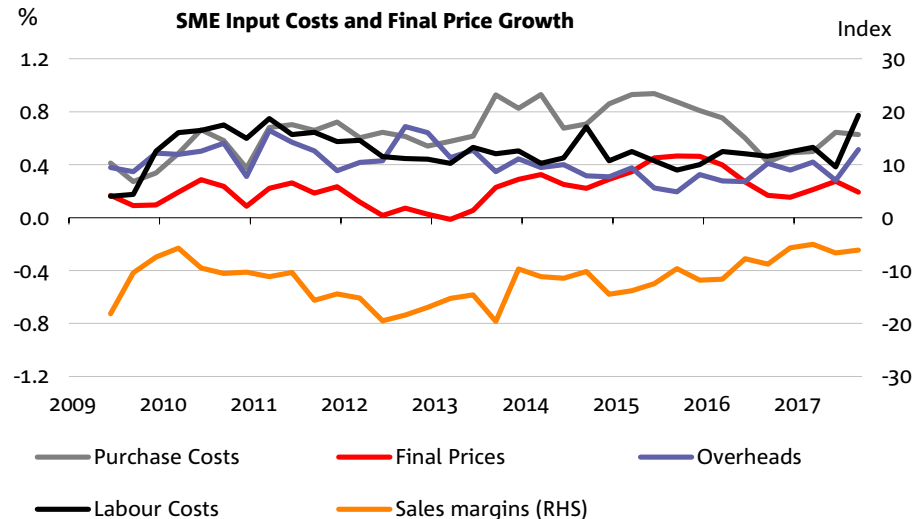
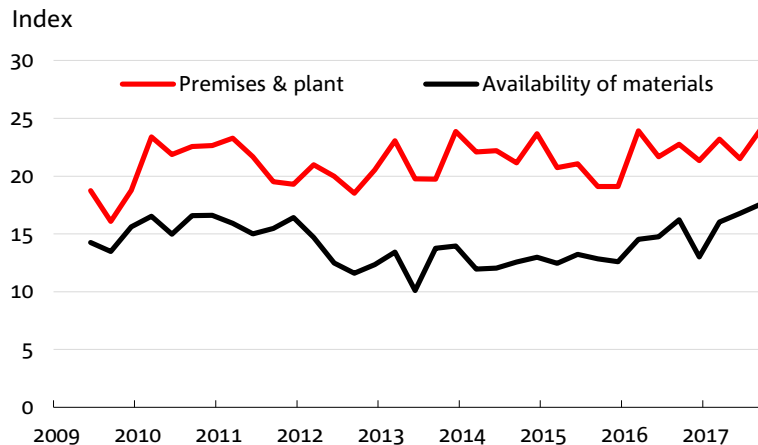
Margins squeezed as input cost growth outstrips final price growth

Factor constraining output



- When asked which factors were currently **constraining output**, sales & orders remained the biggest constraining factor, followed by the availability of suitable labour, premises & plant, and finally the availability of materials. The concerns over all four factors rose during the quarter, with the biggest increases in concerns over the availability of suitable labour and sales & orders. Concerns over the availability of suitable labour have crept up over the past two years. This has been consistent with the overall tightening of the labour market and fall in the unemployment rate during this period (although spare capacity in the labour market does remain). Labour cost growth as reported in the survey also increased to 0.8% q/q from 0.4% in Q2. Concern over the availability of materials has also risen, as surveyed purchase costs price growth increased to around 0.6% q/q from 0.5% in 2016.
- **These constraints are reflected in input costs and final product prices.** Growth in final product prices fell slightly this quarter and remained below input costs growth. Growth in both labour costs and overheads increased this quarter, while growth in purchase cost was steady. As final price growth continued to fail to catch up with input costs growth, margins were squeezed. There have been more firms reporting narrowing sales margins than those with improving margins for a number of years. As a result, this has possibly eaten into SME firms' profitability.

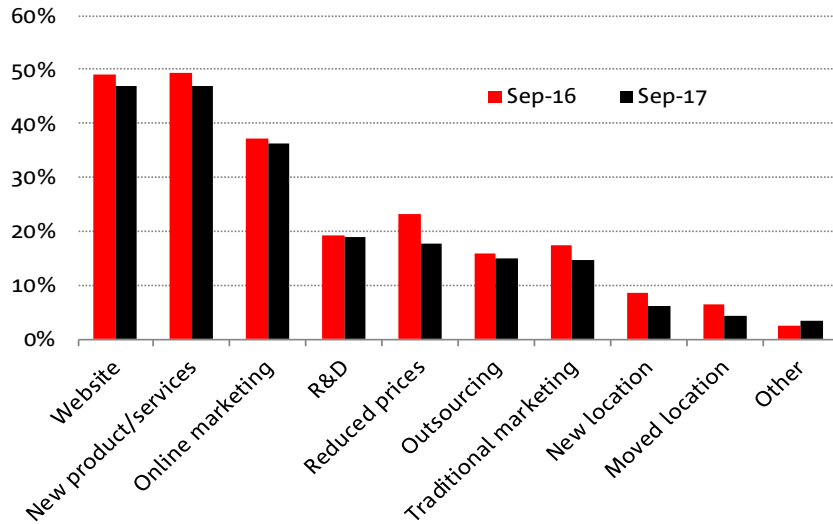
Factor constraining output (continued)



STRATEGIES

Website and new product/services the most popular strategy

Strategies employed to improve competitiveness

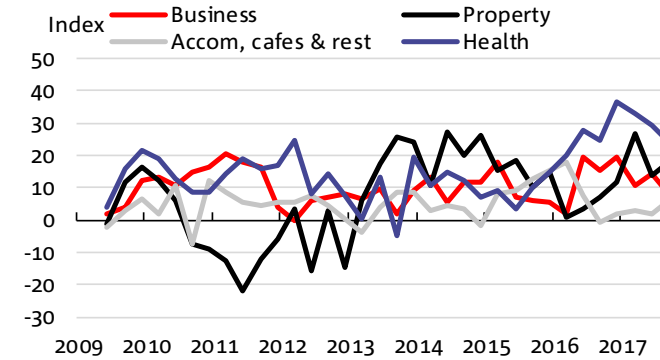
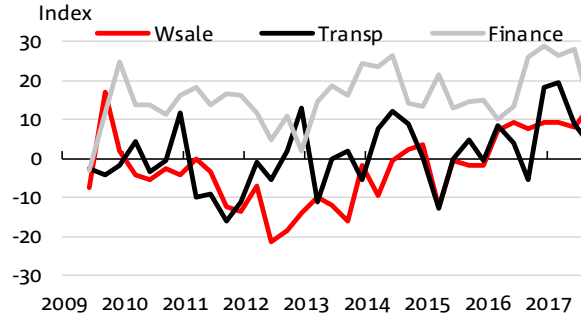
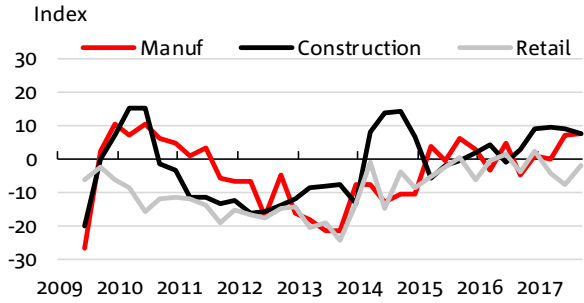


- Most firms have employed one or more **strategies to improve their competitiveness** in the market over the last 12 months. Website and launching new product/services have remained the most popular strategies. While marketing has also been a popular strategy, traditional marketing has given way to online marketing. Opening a new location or moving locations have not been employed by as many, perhaps as that option may not be viable for many SMEs. While price discounting was still used by 17% of firms, it has been losing popularity over time.

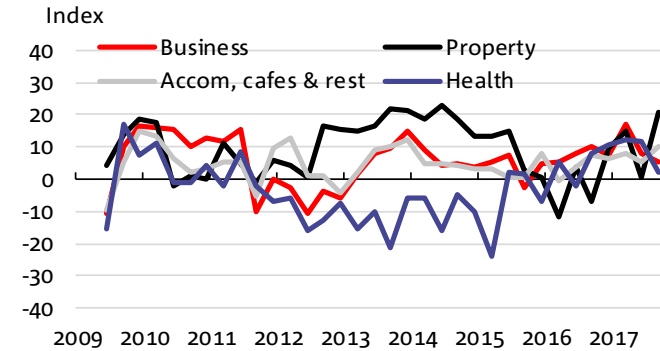
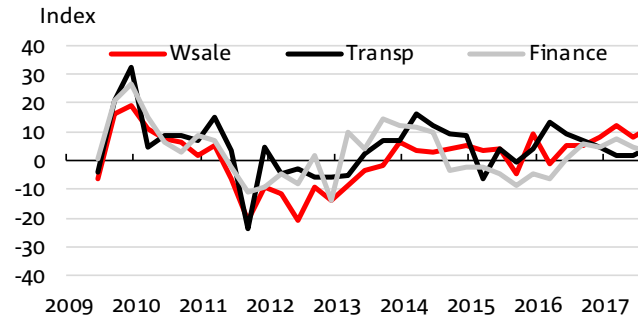
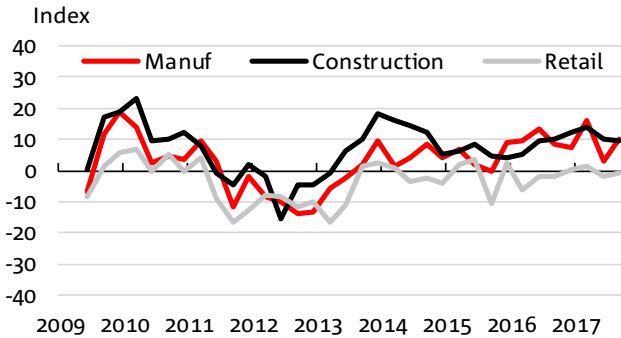


INDUSTRY

BUSINESS CONDITIONS BY INDUSTRY

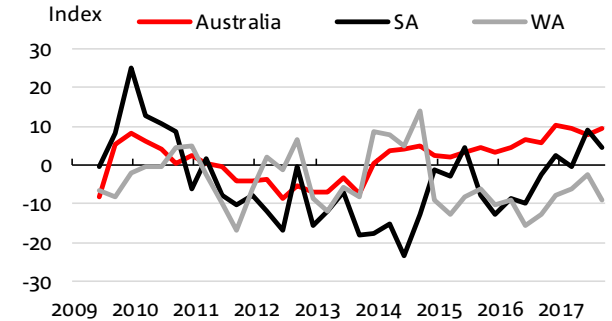
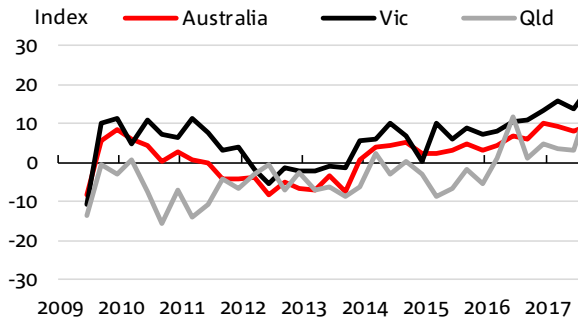
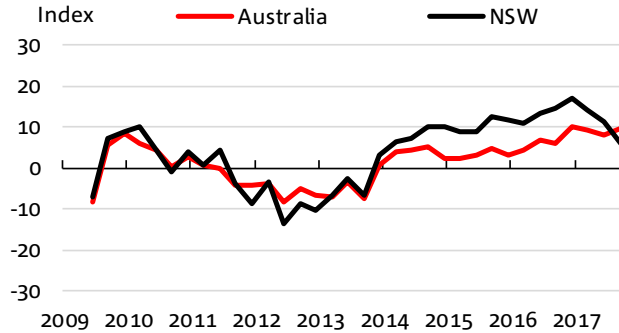


BUSINESS CONFIDENCE BY INDUSTRY

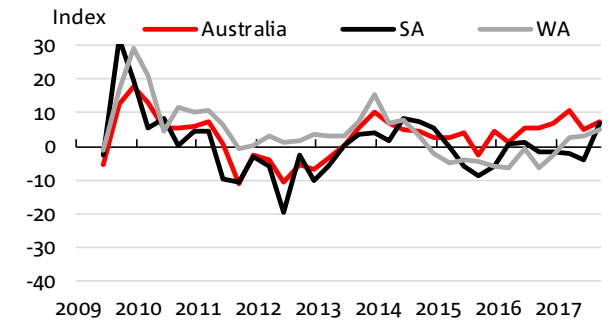
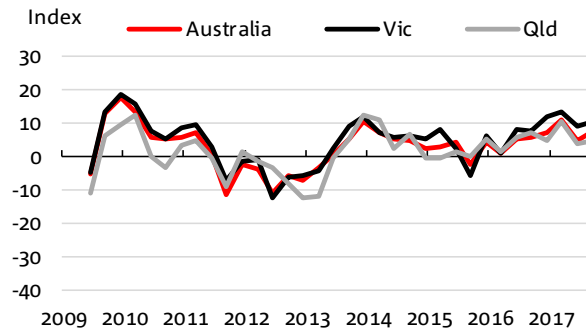
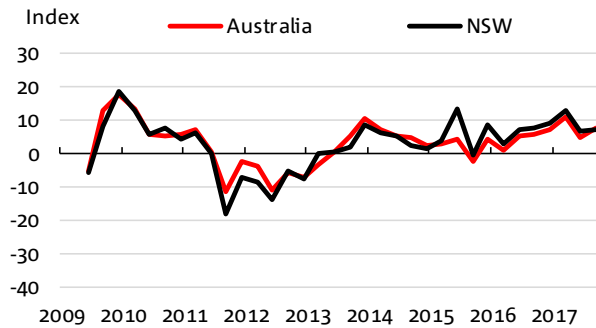


STATE

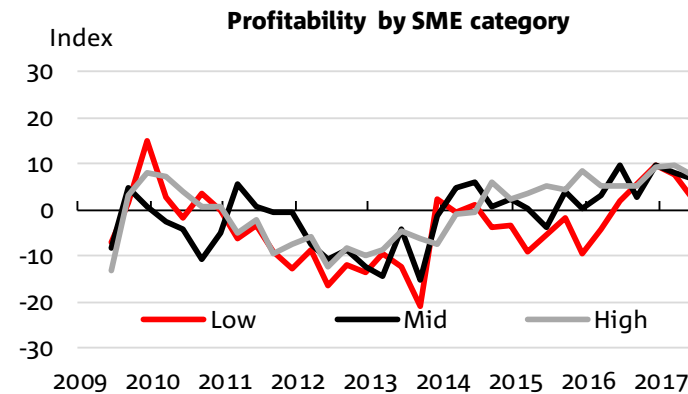
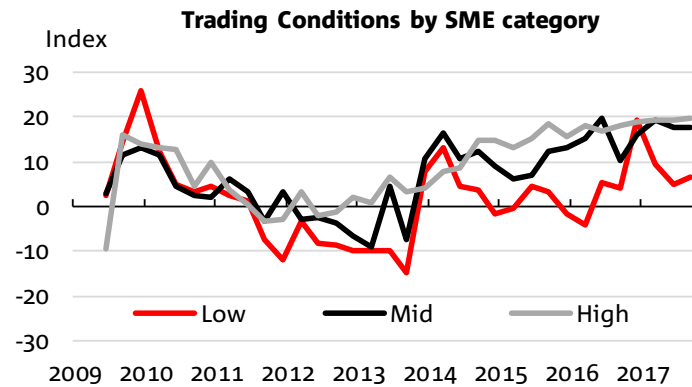
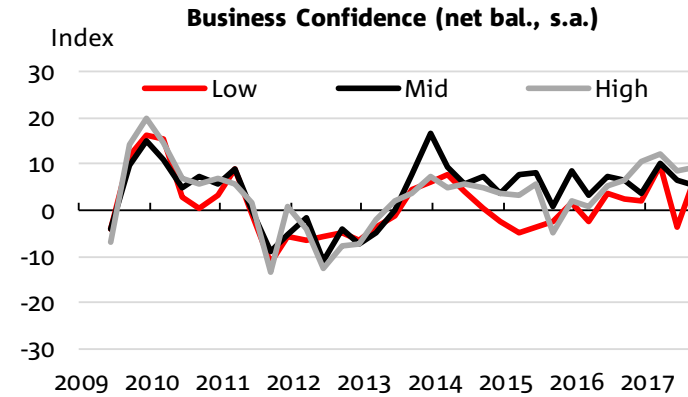
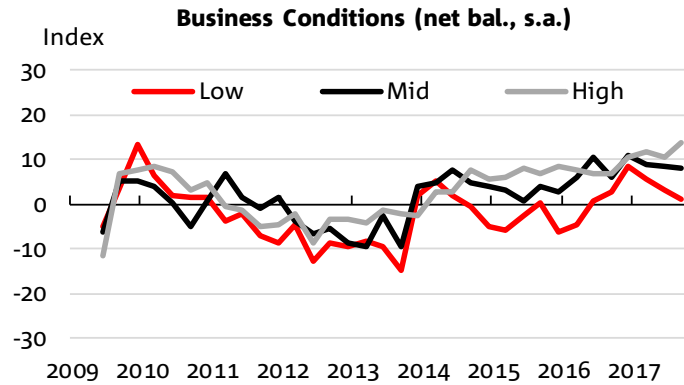
BUSINESS CONDITIONS BY STATE



BUSINESS CONFIDENCE BY STATE



FIRM SIZE



Note:

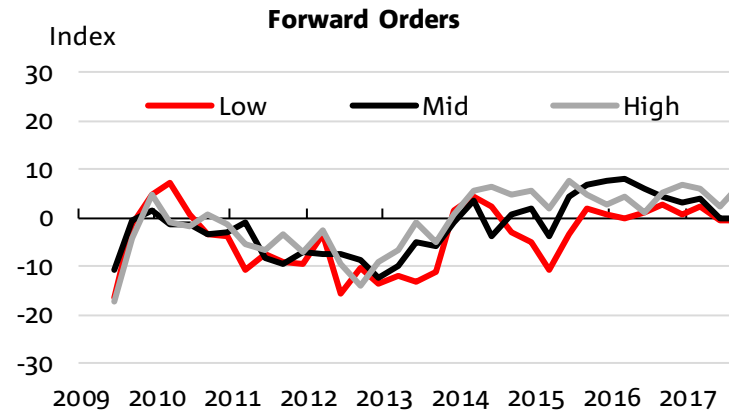
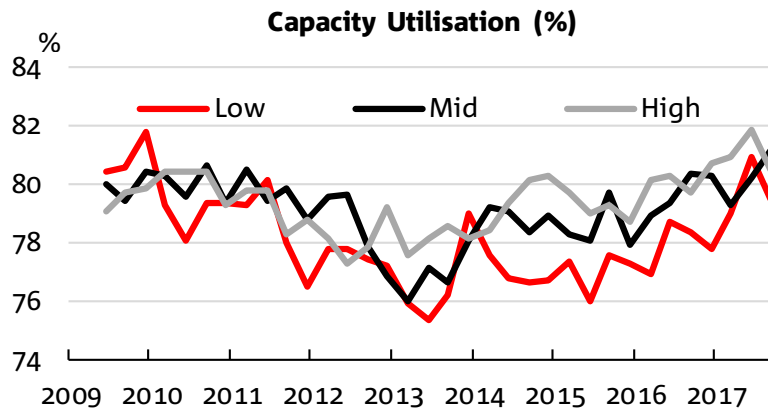
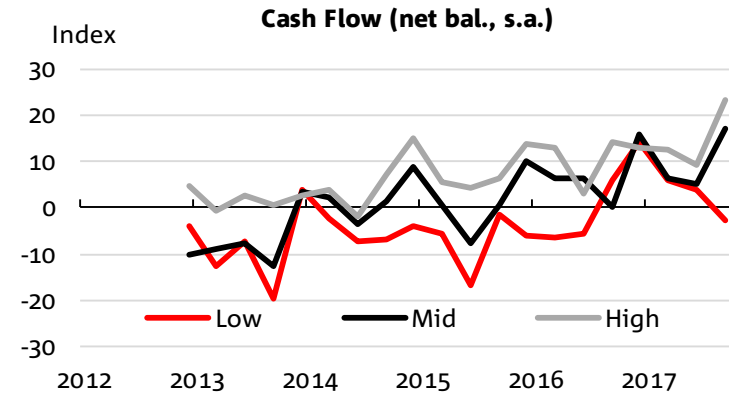
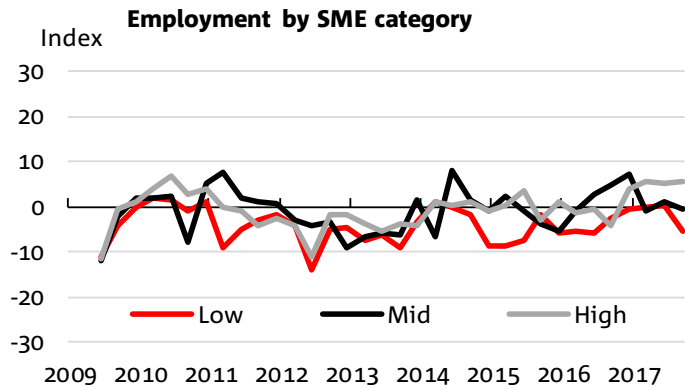
Firm sizes are determined by their annual gross sales.

Low-tier firms: \$2 million - \$3 million

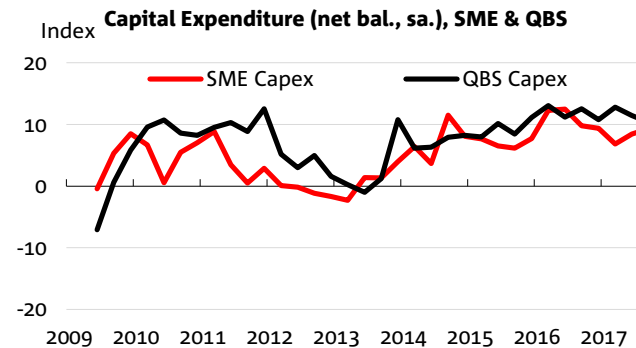
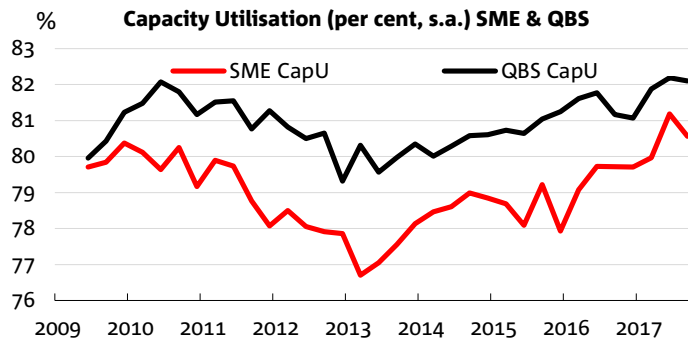
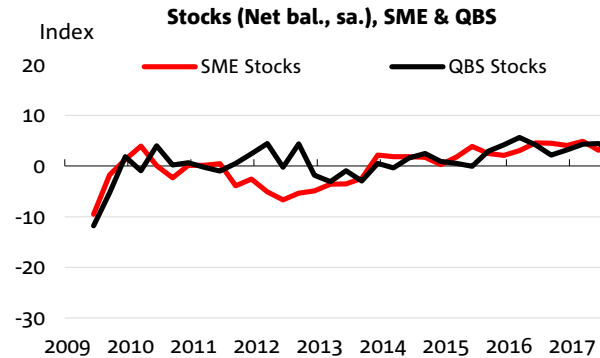
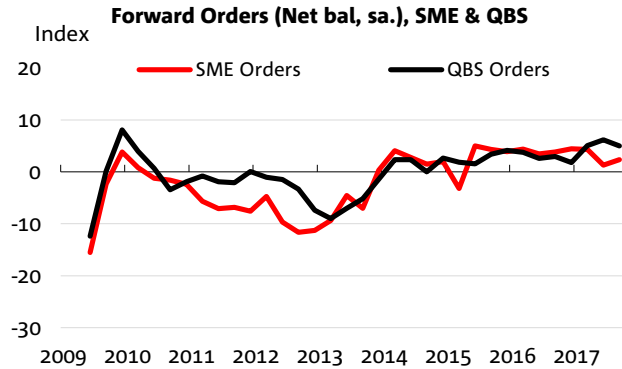
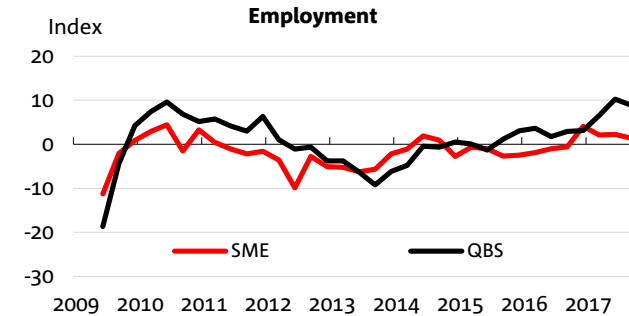
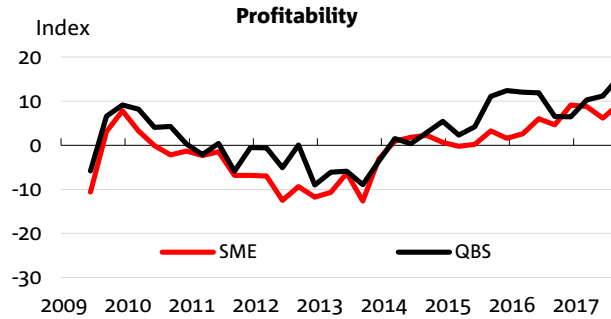
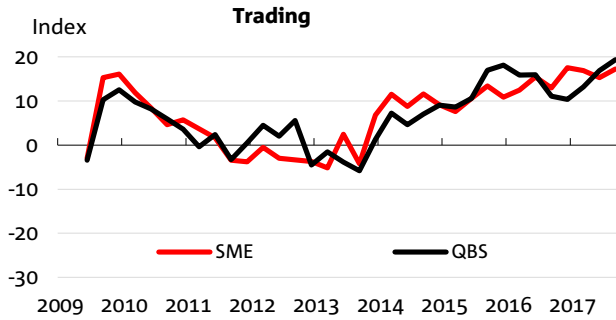
Mid-tier firms: \$3 million - \$5 million

High-tier firms: \$5 million - \$10 million

FIRM SIZE (CONTINUED)



COMPARISON WITH QBS (LARGER BUSINESSES)



Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Riki Polygenis
Head of Australian Economics
+61 3) 8697 9534

James Glenn
Senior Economist – Australia
+61 4)55 052 519

Amy Li
Economist – Australia
+61 3) 8634 1563

Phin Ziebell
Economist – Agribusiness
+61 4) 75 940 662

Behavioural & Industry Economics

Dean Pearson
Head of Behavioural & Industry Economics
+61 3) 8634 2331

Robert De lure
Senior Economist – Behavioural & Industry Economics
+61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+613) 9208 2929

International Economics

Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy

Ray Attrill
Global Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy

Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution

Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Jason Wong
Currency Strategist
+64 4 924 7652

Caroline Down
Publications & Web Administrator
+64 4 474 9771

Asia

Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

UK/Europe

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

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