

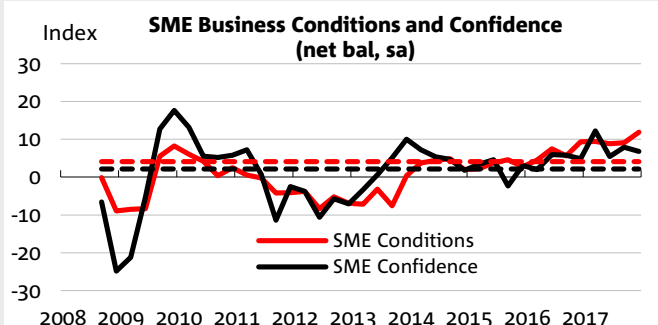
NAB QUARTERLY SME SURVEY

DECEMBER 2017

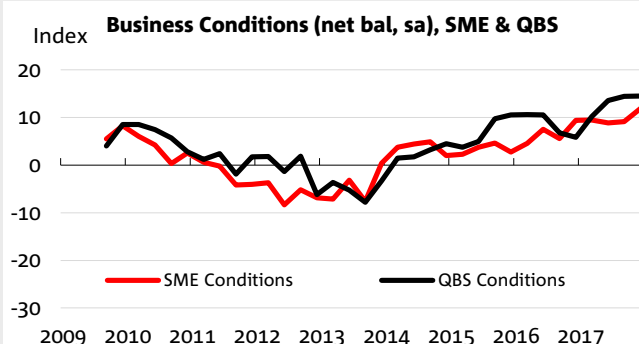


Key points:

- The NAB Small and Medium Enterprises (SME) Business Survey showed a **strong improvement in SME business conditions in Q4 2017, while confidence retreated a touch**. Business conditions increased 3 points to +12 to be at the highest level since 2008. While confidence eased back one point to +7, both conditions and confidence are now above their long-run averages since the survey started in 2006.
- The improvement in SME conditions saw a **narrowing of the performance gap between small and large businesses** (as measured by the NAB Quarterly Business Survey, QBS). Among SMEs, better conditions at the low-tier firms also saw the size gap between the smallest SMEs and the mid-tier and high-tier SMEs narrow. Strong improvements in employment conditions for low and mid-tier firms were particularly encouraging.
- An increasing proportion of firms continued to identify the availability of labour as a major concern**. In Q4 it ranked alongside sales & orders as the top constraint on output. Meanwhile, premises & plant and the availability of materials have also increased in importance as constraining factors over the past year. The tight availability might have contributed to the higher growth rates of input costs than final product price growth. While final product price growth increased slightly in the quarter, it remained below input costs growth. In the meantime, sales margins continued to be squeezed.
- Leading indicators were looking up during the quarter**, a similar trend observed in the QBS. Forward orders, capacity utilisation and capital expenditure were all up, both for SMEs and larger businesses. Stock levels were steady.
- Across states**, Victoria has led the nation in terms of SME business conditions and confidence since overtaking NSW in 2016. NSW has bounced back from the dip in business conditions seen in Q3 2017, and is now reporting the second highest conditions. Despite this, business confidence was down in the two biggest states, dragging down the overall index and similar to the trend for larger businesses in the quarter.
- Across industries**, health again reported the strongest business conditions in Q4. Other services industries including finance, business services, construction and property also outperformed. Perhaps surprisingly, manufacturing showed the biggest improvement in business conditions over the past year. At the bottom end of the scale was retail, which has been struggling with negative business conditions for some years.



Note: Dotted line denote long-run averages



	2017 q2	2017 q3	2017 q4
Business Confidence	5	8	7
Low-tier firms	-3	7	3
Mid-tier firms	7	7	8
High-tier firms	9	10	7
Business Conditions	9	9	12
Low-tier firms	4	2	8
Mid-tier firms	9	9	13
High-tier firms	11	13	12
Trading Conditions	17	17	19
Low-tier firms	7	9	12
Mid-tier firms	19	18	21
High-tier firms	20	20	19
Profitability	7	9	10
Low-tier firms	3	2	7
Mid-tier firms	8	8	9
High-tier firms	9	13	11
Employment	3	2	6
Low-tier firms	0	-6	4
Mid-tier firms	2	0	9
High-tier firms	6	7	6

Note:

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

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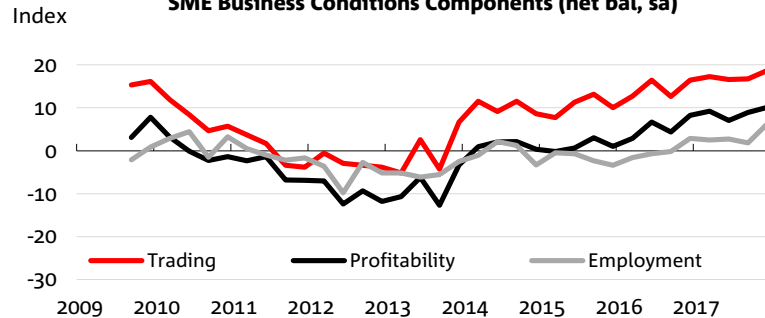
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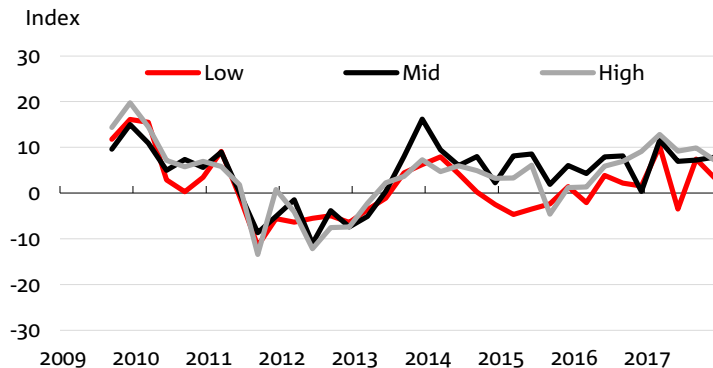
CONDITIONS & CONFIDENCE BY FIRM SIZE

Improvements in business conditions driven by smallest firms while confidence retreated

SME Business Conditions Components (net bal, sa)



Business Confidence by SME category

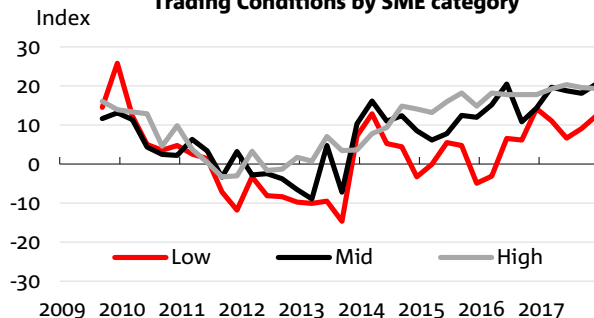


- **SME business conditions improved in Q4**, up 3 points to +12, to reach a new post GFC high. This continued the upward trend in business conditions, which was also observed in the Quarterly Business Survey (QBS) for larger businesses. All three components of business conditions saw an improvement during the quarter. Across firm size, the mid and low tier firms experienced better conditions, while the largest SMEs saw a small pullback in conditions. The gap between the low and mid/high-tier firms narrowed thanks to the strong increase in low tier firm business conditions.
- **Similar to the QBS for larger businesses, business confidence declined slightly during the quarter.** Both high and low-tier SMEs experienced a decline in business confidence, while the confidence of mid-tier firms increased slightly.
- While the larger SMEs have generally reported better business conditions than their smaller counterparts, low-tier firms showed a strong improvement in Q4, across all of trading, profitability and employment. High-tier firms saw a small pull back in all three components, which saw the mid-tier firms overtake to report the best business conditions in the quarter. Mid-tier firms also reported the best business confidence reading in Q4.
- The improvement in low-tier firm business conditions was promising, however confidence declined somewhat. It will be interesting to see if the narrowing of the size gap can be sustained.

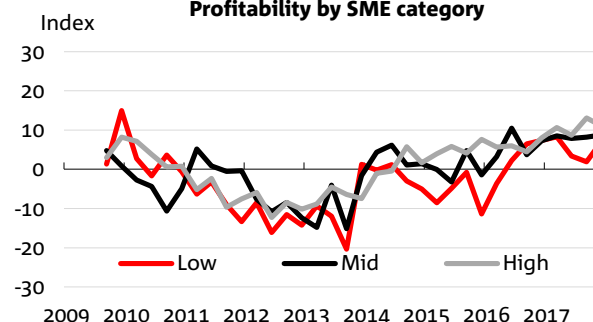
Note:

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

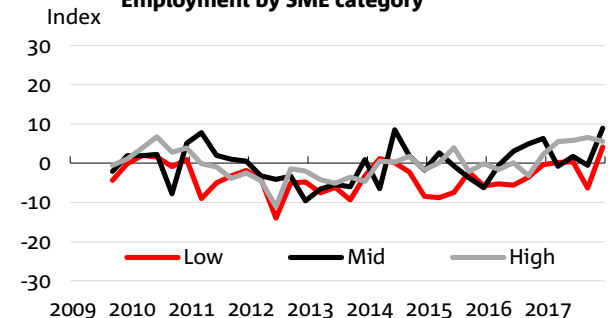
Trading Conditions by SME category



Profitability by SME category

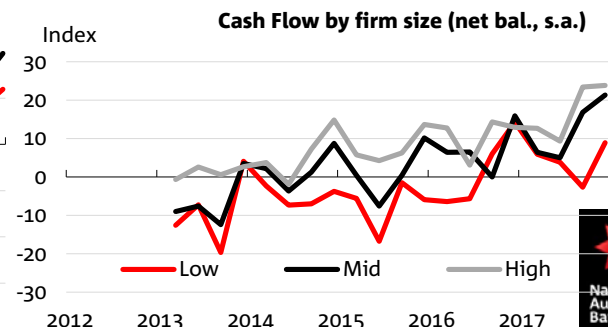
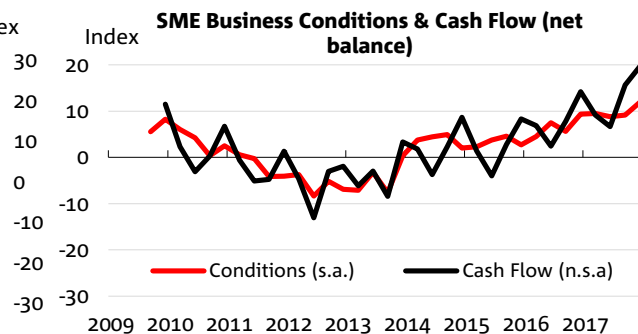
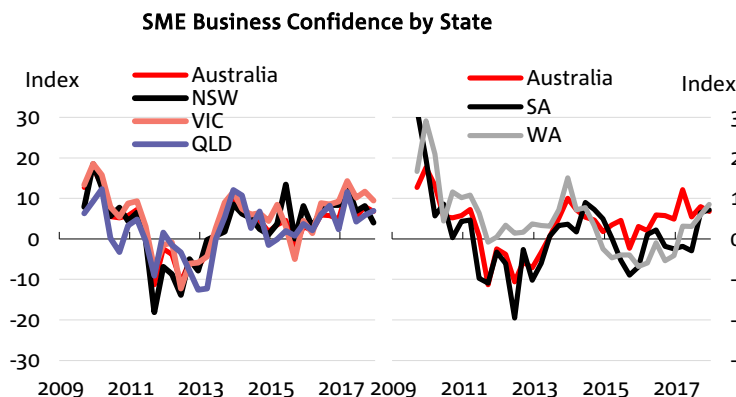
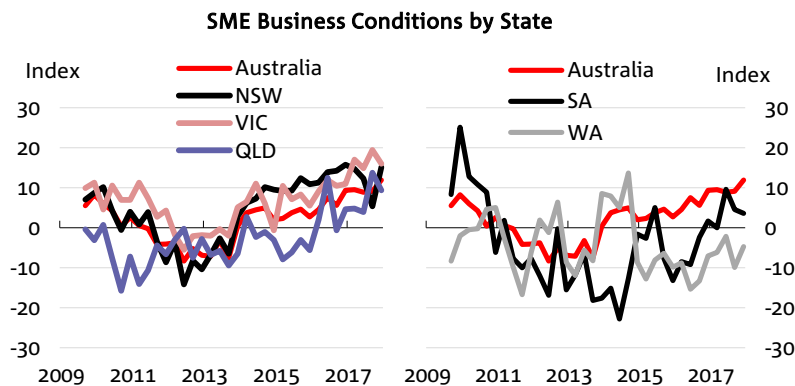
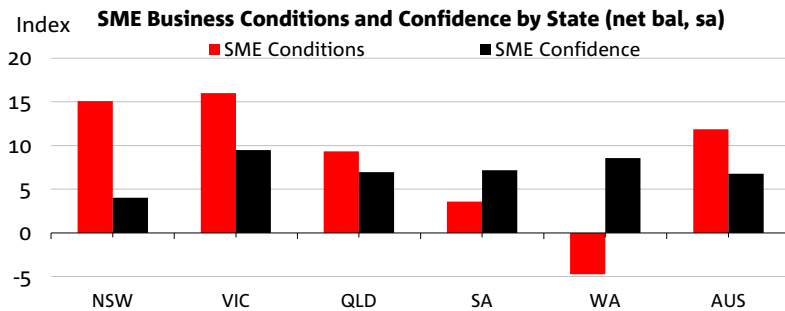


Employment by SME category



CONDITIONS AND CONFIDENCE BY STATE

Victoria again leads although NSW conditions bounced back

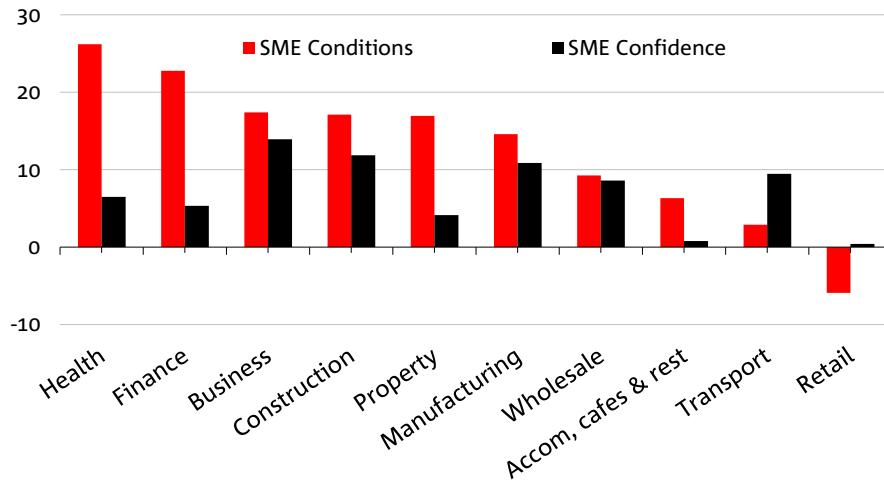


- Since overtaking NSW in 2016, Victoria led the nation both in terms of SME business conditions and confidence throughout 2017. NSW has bounced back from the dip in business conditions seen in Q3 2017, and is now reporting the second highest conditions at +15 points.
- **Business conditions** improved the most in NSW in the quarter, up +10 points to +15. WA conditions also improved by 5 points however remained in negative territory since Q4 2014, continuing to be affected by the end of the mining boom. On the other hand, the remaining mainland states reported lower business conditions, with QLD, VIC and SA down by -4, -3 and -1 points respectively.
- Similar to that for larger businesses, **SME business confidence** declined a touch overall. This was driven by the two biggest states, with NSW confidence declining by 4 points and VIC down by 2. The two mining states of QLD and WA both reported higher confidence, while SA confidence was largely unchanged. At current levels (ranging from index levels of +4 for NSW and +9 for VIC), all mainland states are feeling optimistic about their business outlook, even including WA which has been struggling with more volatile and downbeat business conditions for some time.
- Consistent with better business conditions, **cash flow also increased in Q4**. Cash flow improved the most at low-tier firms and the least at high-tier firms, although the high-tier firms continued to report the strongest cash flow.

CONDITIONS AND CONFIDENCE BY INDUSTRY

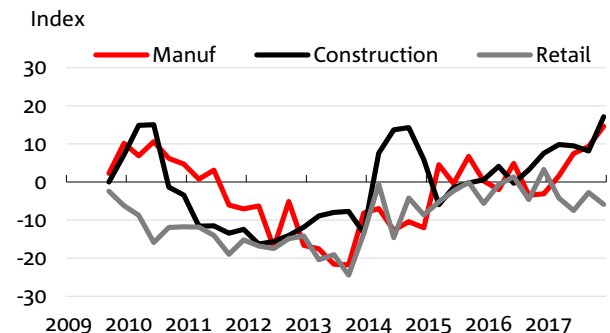
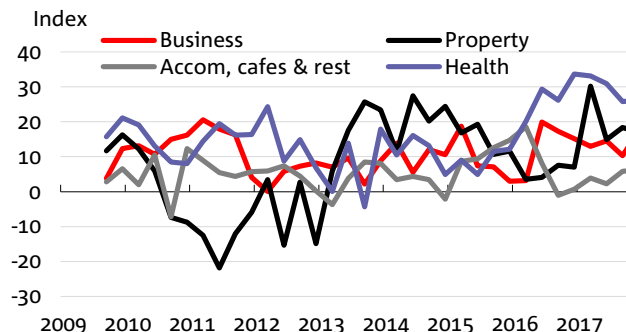
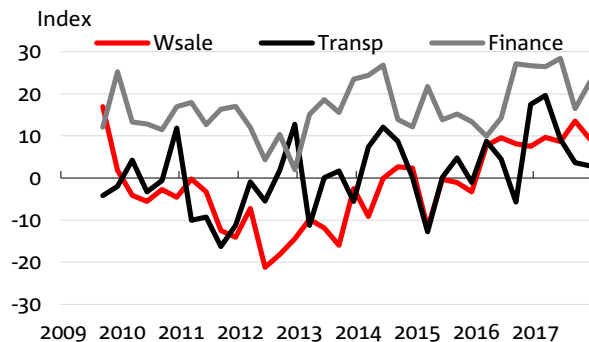
Health again led in business conditions, while retail remained in the negative

Index **SME Business Conditions and Confidence by Industry (net bal, sa)**



- Across industries, health again reported the strongest **business conditions** in Q4. Other services industries including finance, business services, construction and property also reported very strong business conditions. Conditions improved in construction, business services, finance and manufacturing in the quarter, while retail, wholesale, transport and property experienced worsening conditions.
- Perhaps surprisingly, manufacturing showed the biggest improvement in business conditions over the year, rising from negative to +15 points, a strong result indicating expansions in business activity. At the bottom end of the scale was retail, which has been struggling with negative business conditions for some years. The environment the retailers are operating in remains challenging, with slow wages growth and a cautious household sector.
- **Business confidence** was the most upbeat in business services in the quarter, followed by construction, manufacturing, transport and wholesale. Not surprisingly, confidence was the lowest in retail and accommodation, cafes & restaurants, as weak wages growth limits household spending. Confidence increased the most in business services (up +7 points to +14), and declined the most in property services and accommodation, cafes & restaurants. Manufacturing confidence held up at an upbeat level, +11 points, perhaps as the survey was conducted when the Australian dollar was weakening. With the renewed strength in the AUD, it will be interesting to see whether the optimism in manufacturing can be sustained in Q1.
- For more industry details, see page 8.

SME Business Conditions by Industry

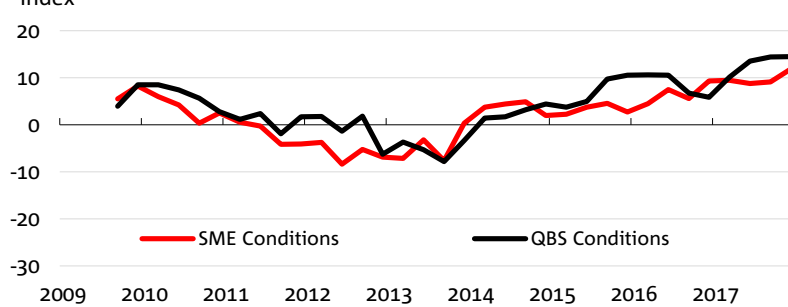


COMPARISON WITH LARGER BUSINESSES

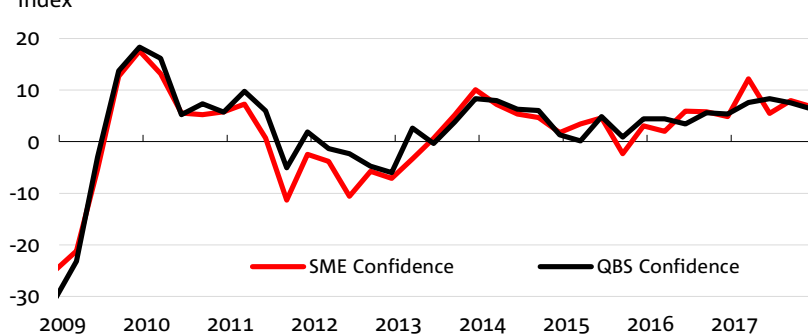
Gap between SME and larger business conditions narrowed

- QBS business conditions were inched up in Q4, while SME conditions picked up strongly, narrowing the gap between small and large businesses. Both SME and QBS confidence declined slightly.
- Looking deeper into the **components of business conditions (trading, profitability and employment)**, trading conditions were largely similar in the SME and QBS surveys, while SMEs have been facing lower profitability and more subdued employment conditions (more details on page 12). The pickup in SME employment conditions in the quarter was encouraging. At +6, it was the highest reading since the GFC and consistent with an expansion in SME employment. It however remained well below the +10 reading for QBS employment conditions. Trading conditions were at +19 and +18 in the SME survey and QBS respectively, both of which have been improving over the year. While profitability conditions in both surveys have been rising as well, SME profitability remained lagging behind, at +10 points compared to QBS' +15.
- **Leading indicators were looking up during the quarter, a similar trend to that observed in the QBS.** Forward orders, capacity utilisation and capital expenditure were up, both for SMEs and larger businesses. Stock levels held steady, at +6 and +3 respectively for the SME survey and the QBS, suggesting that firms anticipate a pickup in demand. Larger businesses, however, report higher levels of orders, capex and capacity utilisation than SMEs. Capacity utilisation at SMEs has been consistently lower.
- For more details, see page 12.

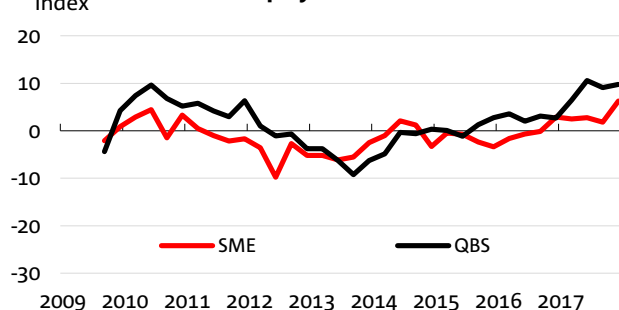
Business Conditions (net bal, sa), SME & QBS



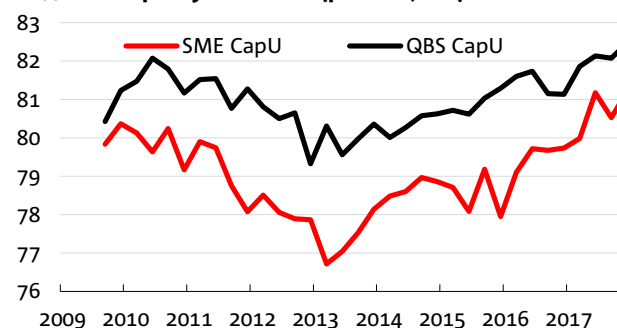
Business Confidence (net bal, sa), SME & QBS



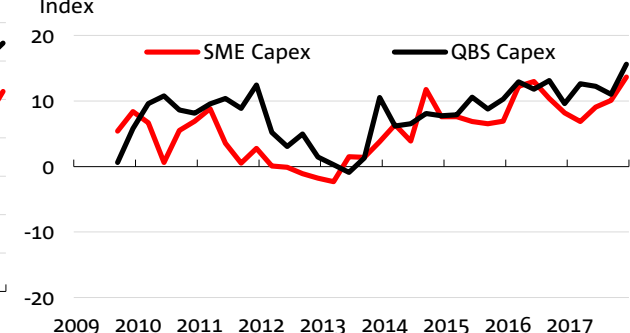
Employment



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

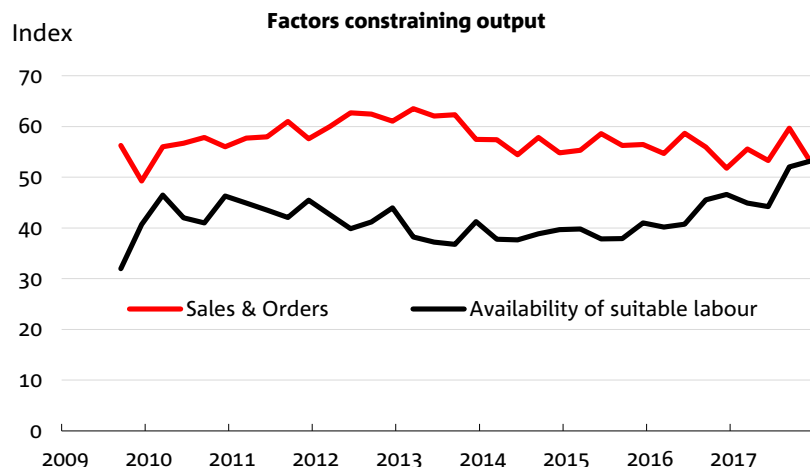


Capital Expenditure (net bal., sa.), SME & QBS

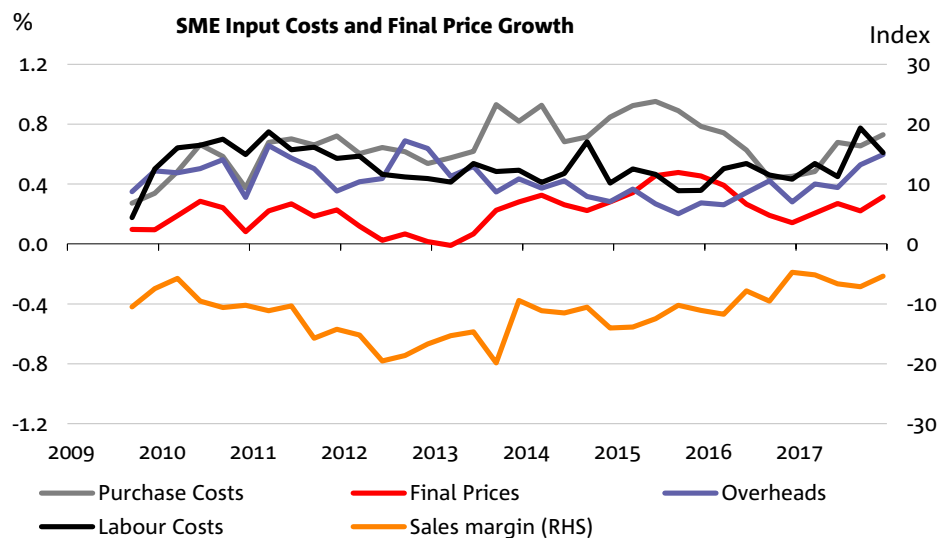
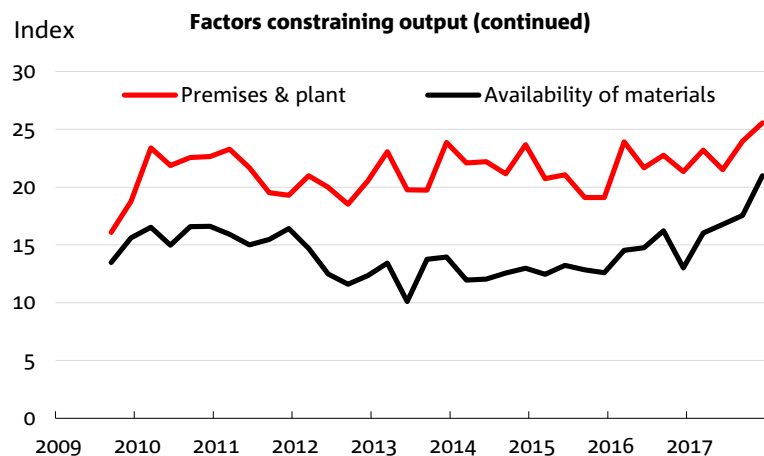


CONSTRAINTS ON OUTPUT AND PRICE MEASURES

Availability of suitable labour increasingly becoming a major concern



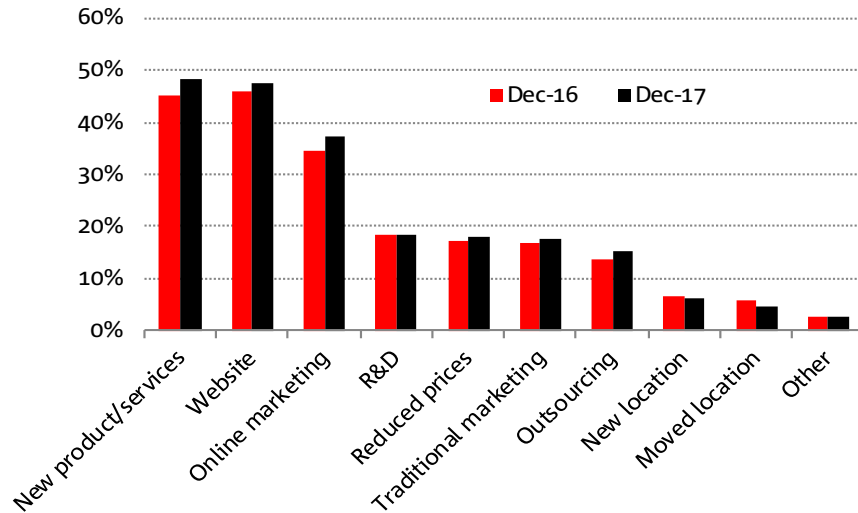
- When asked which factors were currently **constraining output**, the availability of labour has increasingly become a major concern. In Q4 it ranked alongside sales & orders as the top constraint on output for SMEs. Meanwhile, premises & plant and the availability of materials have also increased in importance as constraining factors on output over the past year.
- Concerns over the availability of labour have been increasing over the past two years. This has coincided with the labour market improving significantly in the past year and the unemployment rate continuing to fall. This series has often led a pickup in wages growth with a lag. For now however, labour costs growth as reported in the survey fell slightly to 0.6% q/q in Q4 from 0.8% q/q in Q2, but remained above final price growth.
- The tight availability might have contributed to the higher growth rates of input costs compared to final product price growth. While final product price growth increased slightly in the quarter, it remained below input costs growth. Final product price growth was 0.3% q/q in Q4, compared to purchase costs growth of 0.7%, overheads growth of 0.6% and labour costs growth of 0.6%. As a result, sales margins continued to be squeezed. With an index reading of -5 points, more firms were faced with declining margins than those with improving margins, however it has become less negative over the past few years.



STRATEGIES

New product/services and websites the most popular strategy

Strategies employed to improve competitiveness

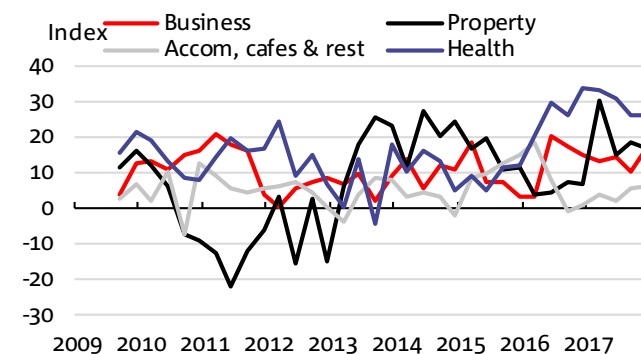
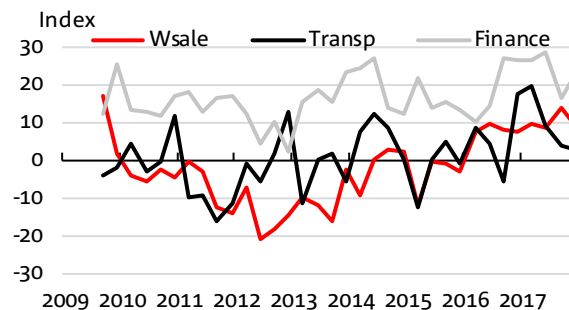
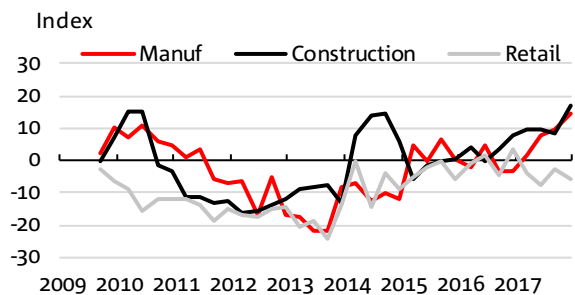


- Most firms have utilised one or more **strategies to improve their competitiveness** in the market over the last 12 months. Website and launching new product/services have remained the most popular strategies. While marketing has also been a popular strategy, traditional marketing has given way to online marketing. Opening a new location or moving locations has not been employed by as many, perhaps as that option may not be viable for many SMEs. Fewer than 20% of firms have used price discounting or outsourcing as a strategy, despite their perceived popularity.

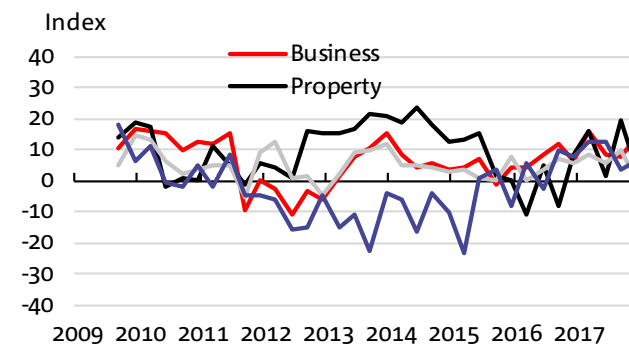
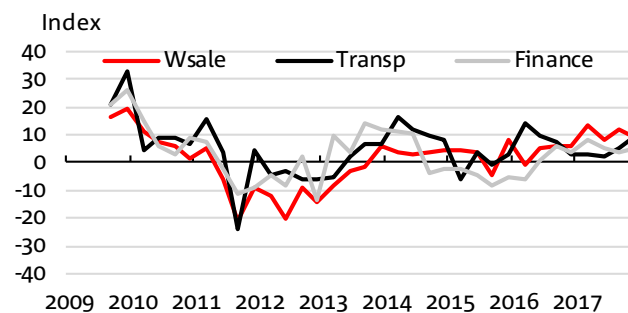
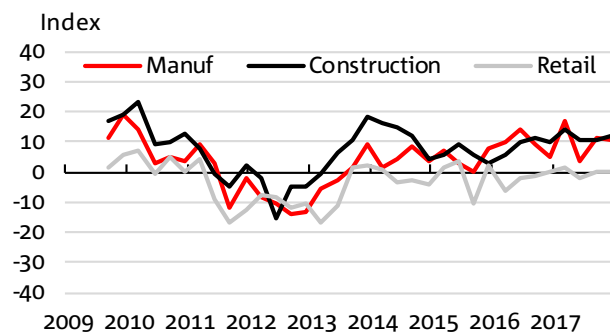


INDUSTRY

BUSINESS CONDITIONS BY INDUSTRY

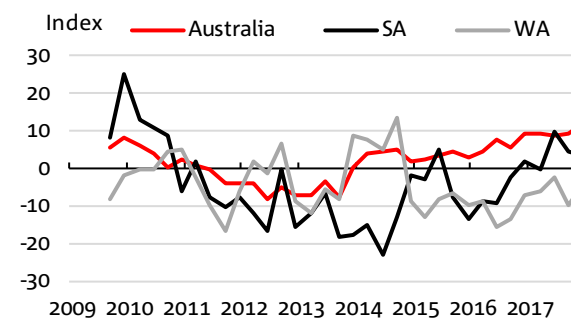
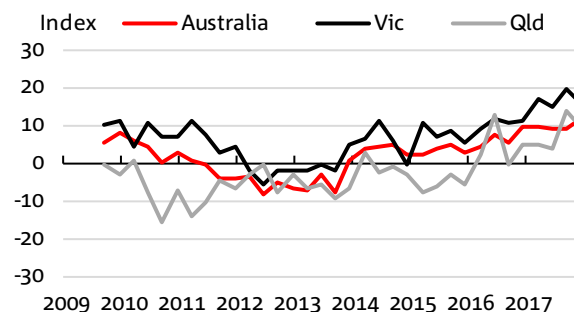
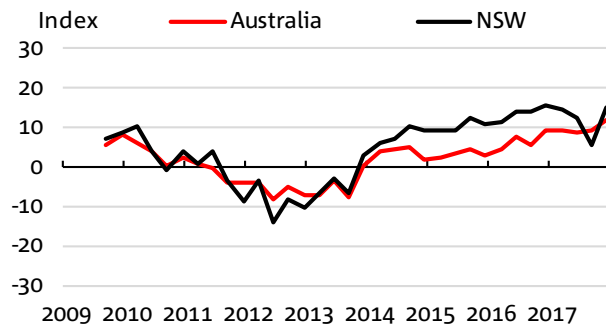


BUSINESS CONFIDENCE BY INDUSTRY

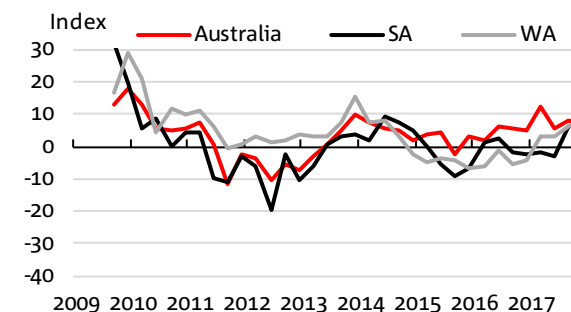
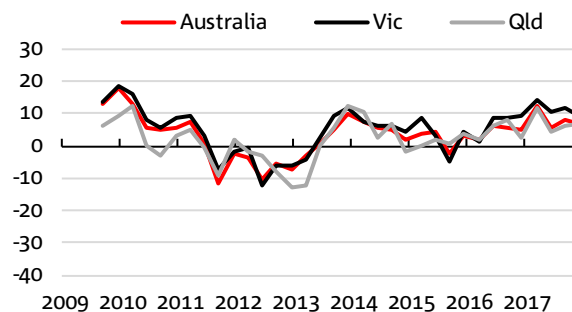
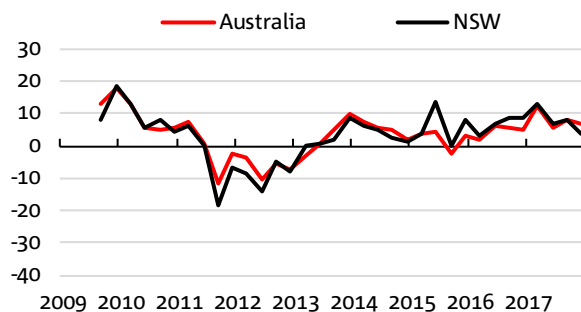


STATE

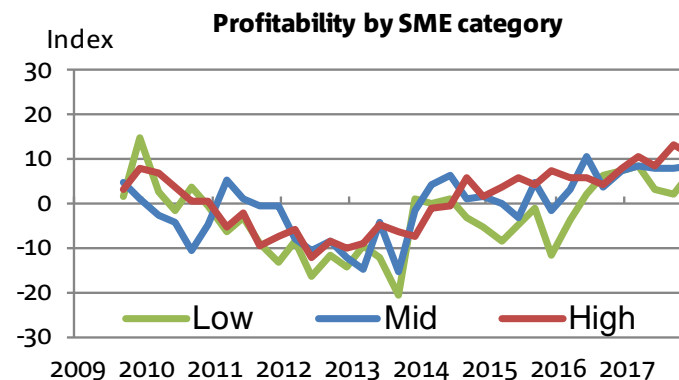
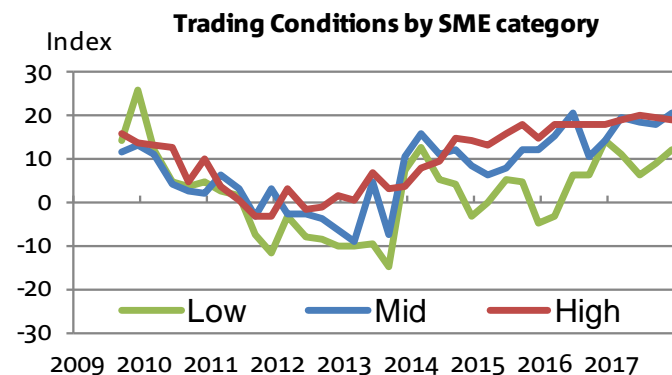
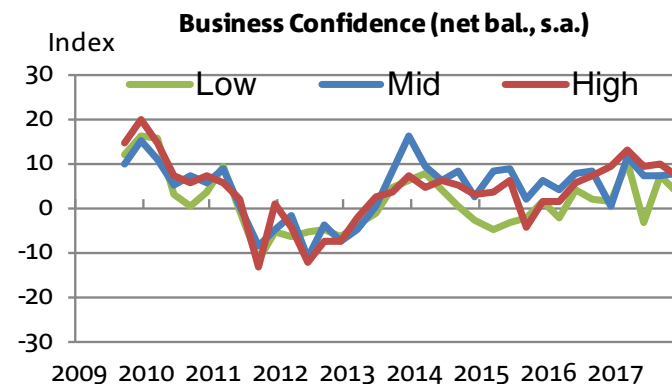
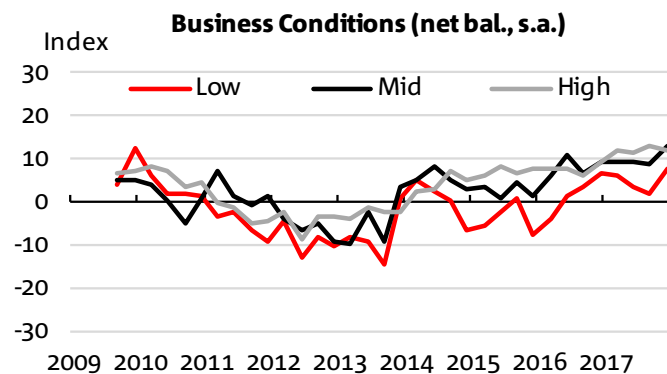
BUSINESS CONDITIONS BY STATE



BUSINESS CONFIDENCE BY STATE



FIRM SIZE



Note:

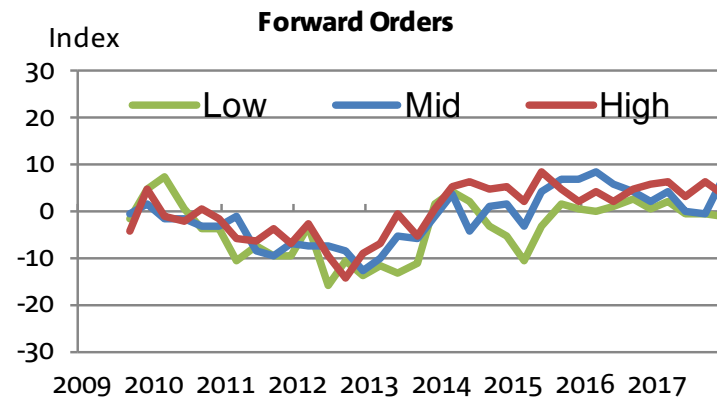
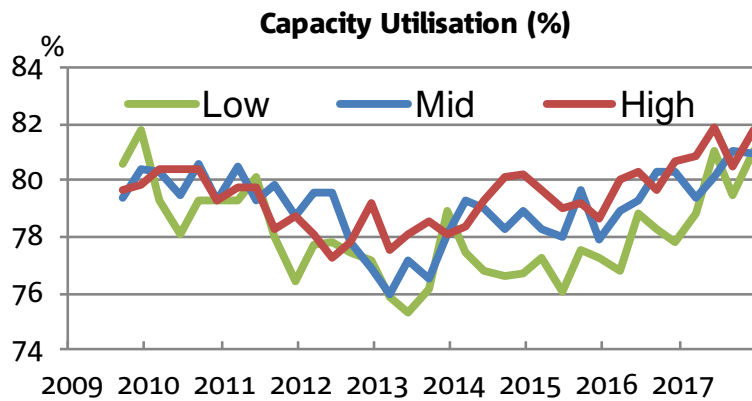
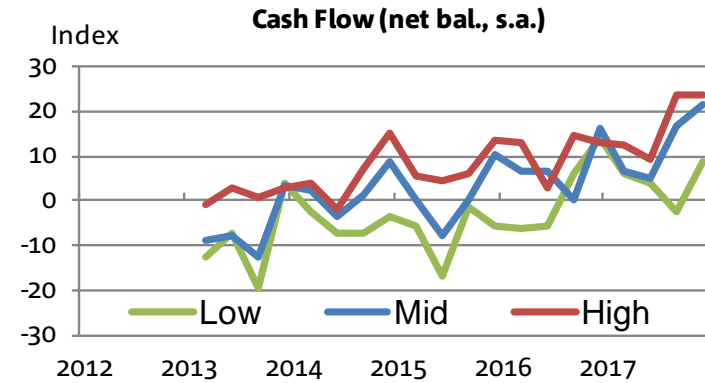
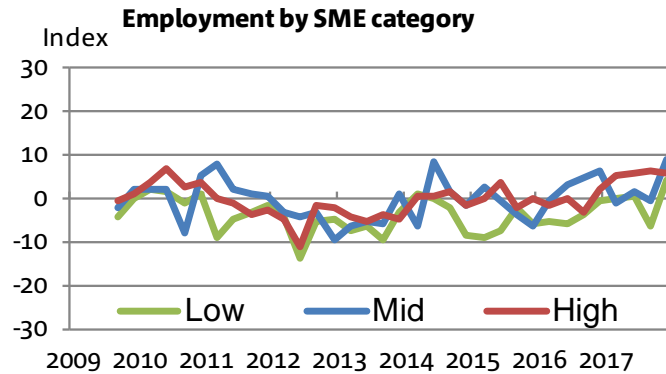
Firm sizes are determined by their annual gross sales.

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

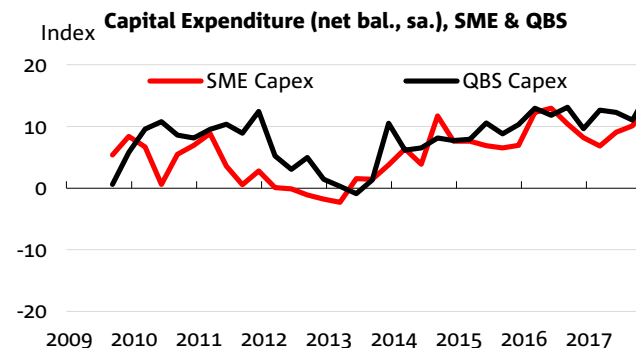
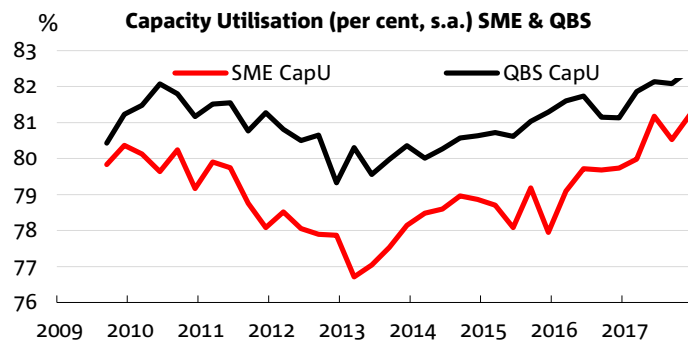
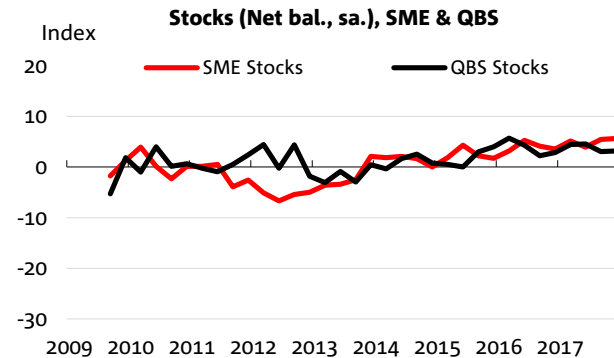
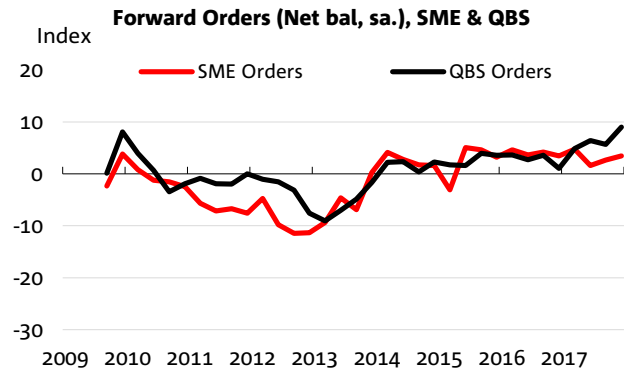
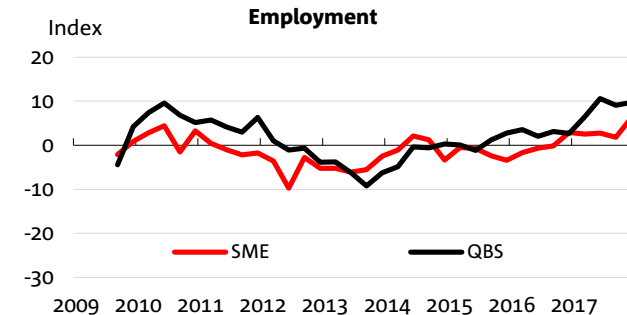
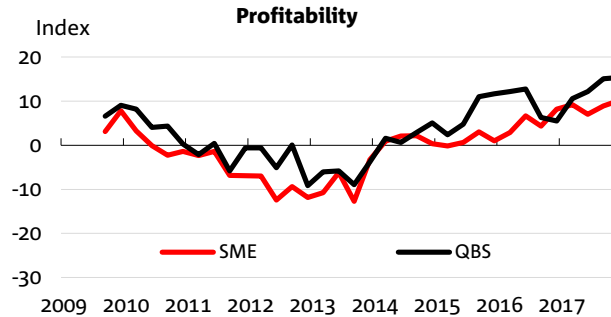
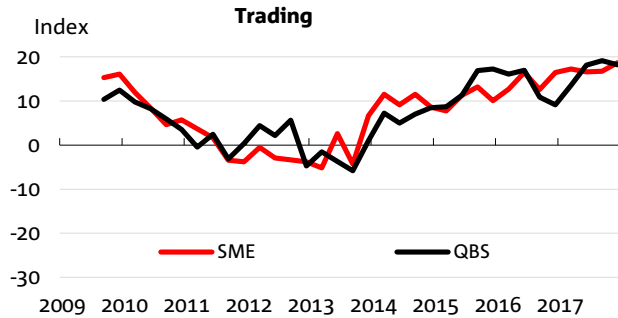
Mid-tier firms: \$3 million - \$5 million

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

FIRM SIZE (CONTINUED)



COMPARISON WITH QBS (LARGER BUSINESSES)



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