

Business buffers being put to good use

26 August 2024



Businesses are preparing for better days

Welcome to the latest quarterly business snapshot

The quarterly business snapshot uses Westpac Group's proprietary data to provide you with a timely picture on Australian businesses. Our report analyses the millions of daily transactions made by our business banking clients, unlocking a rich source of data on businesses nationwide.

This latest update showed a further stabilisation in business conditions in the final quarter of the 2023-24 financial year. Topline revenue continued to decline as higher average taxes, higher interest rates, and above target rates of inflation remain significant headwinds for consumers. This fall in revenue was largely offset by businesses achieving increased cost efficiencies.

This quarter we looked beneath the 'aggregates' to better understand how individual businesses are performing. Encouragingly, a growing share of commercial businesses are seeing their cash flow grow and improve, despite the headwinds hitting the economy.

We also find that the divide between commercial and small and medium sized businesses (SMEs) has widened. More SMEs are seeing their cash

flow become constrained. There is also a divergence in geography with the mining states, including WA and Queensland, outperforming.

Against this backdrop, businesses have started to put their financial firepower to good use. It is no surprise that commercial businesses are looking ahead and are using their balance sheet strength to invest. These businesses are getting ahead of the curve and are setting up to take advantage of future opportunities. On the other hand, SMEs are drawing down on credit lines to boost liquidity and smooth cash flow until growth across the economy picks up.

The effort businesses put in to strengthen balance sheets during, and after, the pandemic is now clearly paying dividends.

The worst looks to be behind us, and we expect the economy to stabilise before staging a recovery as we progress through 2024 and into 2025. Cost of living support, tax cuts, moderating inflation, and eventually, lower interest rates will support consumer disposable income and spending. This will have positive flow on effects for businesses of all sizes.





Cash flow insights: Conditions stabilise ahead of a likely lift

Cost efficiencies have offset the decline in spending

In the June quarter, topline revenue declined 0.7%, which was better than the fall of 2.4% recorded in the March quarter.

Remember, we are looking at nominal revenue, which is comprised of changes to prices and the quantity of goods and services sold. As such, at least part of the decline in revenue is due to moderating growth in prices. Over the year to the June quarter, topline revenue declined by a hefty 3.9%.

On the other side of the ledger, growth in expenses accelerated to increase 0.6% in the June quarter. The bounce in aggregate expenses was

12-month change:

↓ -3.9%
Income

↓ -3.9%
Expenses

↑ +3.5%
Debt servicing costs

Income to expense ratios (including debt costs) are back at their pre-pandemic levels in WA and Qld.

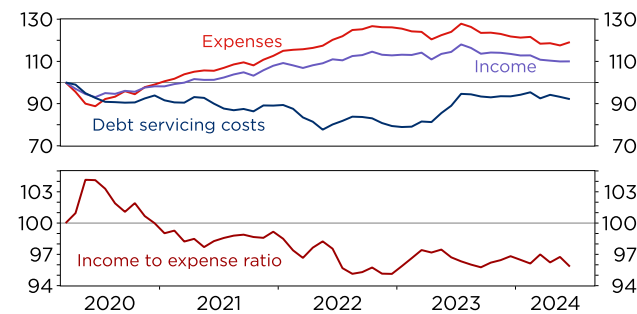
driven by commercial businesses expanding their underlying capacity, with SMEs recording a fall in expenses. Notwithstanding this quarterly increase, expenses have declined materially over the past year, falling by 3.9%.

Debt servicing costs declined 0.4% in the June quarter but were 3.5% higher in annual terms. Debt servicing payment flows are still below pre-pandemic levels despite higher interest rates, reflecting stronger balance sheets.

As costs pressures continue to moderate, businesses look to further boost costs efficiencies, and the squeeze on household incomes gradually subsides, cash flow conditions are expected to improve as we progress through the remainder of 2024.

Business cash flow

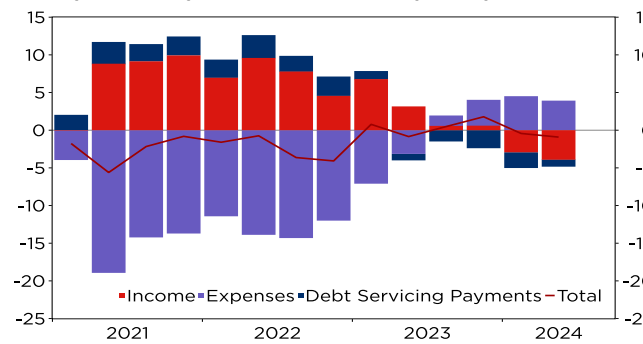
Including debt servicing, Rolling 3-month sum, Index March 2020 = 100



Source: Macrobond, Westpac Economics

Income to expense ratio

Including debt servicing, Contribution to annual change, Rolling 3-month sum



Source: Macrobond, Westpac Economics

The two speed economy

Cash flow conditions are becoming more dispersed across different states.

Income growth in WA picked up in the June quarter and was flat in Qld. This was in stark contrast to NSW and Vic where income declined in the quarter.

Despite the above average growth in expenses in WA and Qld, cash flow conditions, as measured by the income to expense ratio (including debt servicing costs), remained around pre-pandemic levels.

Conditions picked up in SA over the June quarter, on the back of a sharp fall in costs. This saw cash flow conditions in SA also return to pre-pandemic levels.

Conditions continue to lag in Vic and NSW, with the fall in income more than offsetting the moderation in cost pressures seen in the June quarter. As a result, cash flow conditions edged lower in these regions and remain below pre-pandemic levels.



Balance sheet insights: Financial firepower supporting activity

Commercial businesses are investing for tomorrow

As we have previously highlighted, businesses entered the post-pandemic period from a position of financial strength. Temporary windfalls flowing from government support, and on the back of strong demand following lockdowns, were used to pay down debt and build financial buffers.

This has been of great help during the Reserve Bank's interest rate hiking cycle – the balance sheet strength has meant debt servicing requirements have not increased as much as would have otherwise been the case. It has also meant businesses have had more scope to effectively deal with slowing demand and higher costs.

Debt servicing expenses remain well below pre-pandemic levels despite the RBA lifting interest rates. This differs across states, with debt services expenses higher than pre-pandemic levels in Vic, SA and WA.

Equipment finance for commercial businesses is increasing at its fastest pace in almost two years.

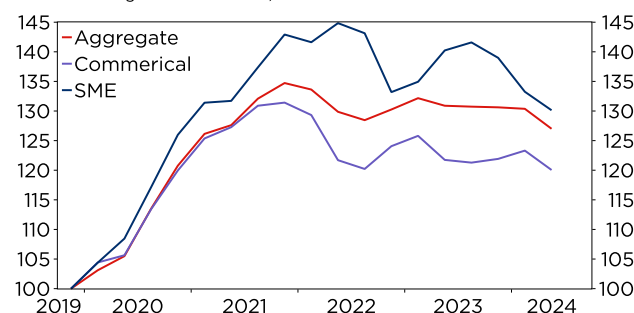
But the benefits of stronger balance sheets do not end there. Businesses can use their strong balance sheets to invest, or they can draw down on credit lines, when the economy and revenues slow.

And that's exactly what we saw in the June quarter – our liquidity measure declined by around 4 percentage points in the June quarter – the first sharp decline in the post-pandemic period. The stock of deposits continued to grow, however, it was more than outpaced by growth in business credit.

Calculating liquidity:
Our liquidity measure assesses the stock of cash relative to businesses' financial liabilities.

Business liquidity ratio by size

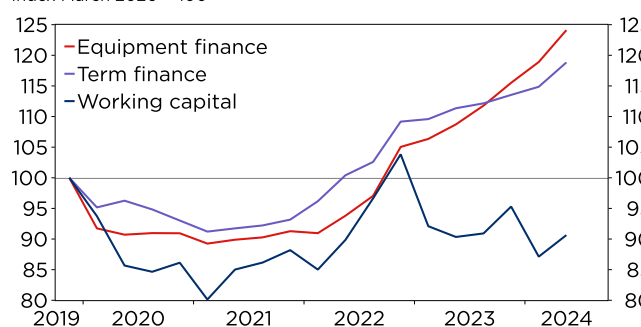
Stock of savings relative to debt, Index Dec 2019 = 100



Source: Macrobond, Westpac Economics

Commercial business debt by type

Index March 2020 = 100



Source: Macrobond, Westpac Economics

SMEs using credit lines to supplement cash flow

The composition of balance sheets is also becoming more dispersed across businesses of different sizes.

Commercial businesses are borrowing to invest in capacity – they see opportunities now and are backing themselves to make the most of these opportunities.

SMEs on the other hand are drawing down on credit lines, which were freed up as they strengthened their balance sheets, to supplement their cash flow.

These businesses want to be around tomorrow when activity picks up and are using their strong balance sheets to create a bridge to the other side.

Notwithstanding the decline in the liquidity ratio, these businesses still have headroom left in their pre-existing lines of credit should it be required – the utilisation of existing credit facilities still remains relatively low.



A look under the 'aggregates': Commercial businesses outperform

Commercial businesses are recording improved conditions

No two businesses are the same. They all vary considerably when it comes to size, operations, governance structure etc. At times looking at the average experience across businesses makes sense. At other times, particularly around turning points, the “average” experience becomes less typical, and it pays to look at what’s happening at the business level. That’s exactly what we have done this quarter.

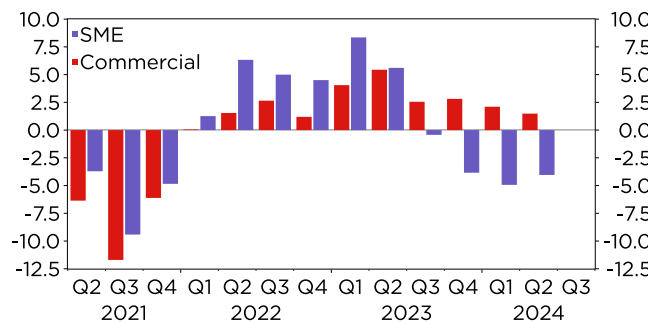
As a result of the slowdown in the economy, the number and share of businesses experiencing an increase in revenue and cash flow conditions (as measured by the income to expense ratio, including debt servicing costs) has fallen over the past year. This fall has been driven by SMEs.

Encouragingly, we find that a growing share of commercial businesses have recorded above average growth in their cash flows, despite the economic challenges impacting the economy. Commercial businesses located in the mining states have outperformed.

We also found that the divide between commercial businesses and SMEs has widened. More businesses are seeing cash flow become constrained, with this entirely driven by SMEs. Smaller businesses are finding it harder to pass on higher costs and this is being reflected in their cash flow. We find that the share of businesses experiencing cash flow constraints increased by around 3 percentage points. The increase was less pronounced in the mining state states.

Share of businesses with improving cash flow

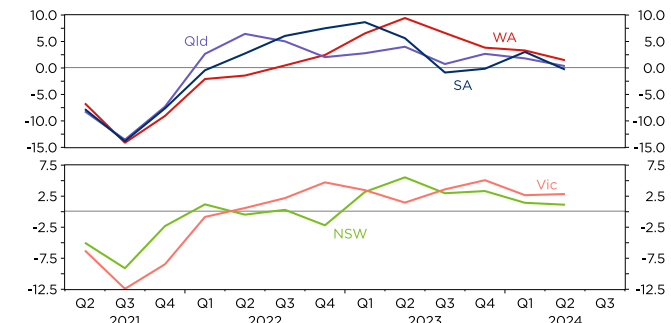
Percentage point deviation from average, Rolling 6-month average



Source: Macrobond, Westpac Economics

Share of businesses growing cash flow

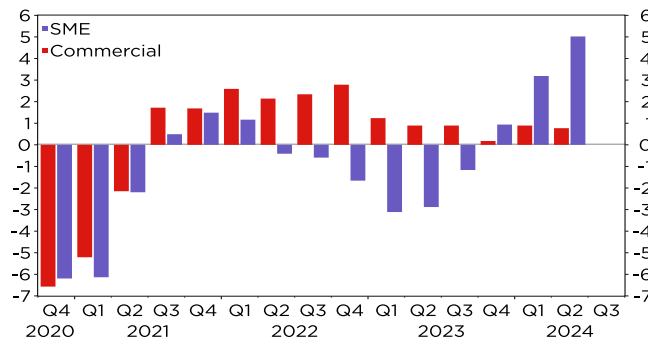
Percentage point deviation from average, rolling 6-month average



Source: Macrobond, Westpac Economics

Share of cash flow constrained businesses

Percentage point deviation from average, Rolling 12-month average



Source: Macrobond, Westpac Economics

Share of cash flow constrained businesses

Percentage point deviation from average, Rolling 12-month average



Source: Macrobond, Westpac Economics



Industry insights: Mixed end to the financial year

Industries catering to the growing population have outperformed

Cash flow conditions also differ across industries. Those industries at the coal face of the consumer led slowdown have underperformed - this includes retail and wholesale trade as well as recreational services.

On the other hand, industries catering to Australia's rapidly growing population, such as private sector providers of health and education, have outperformed. Activity in these sectors is often heavily impacted by government subsidies.

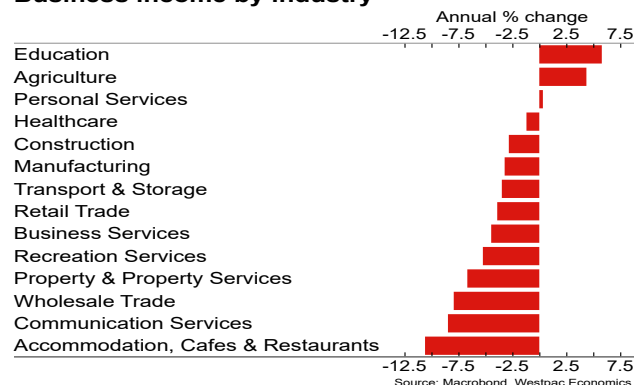
Relative to pre-pandemic levels, cash flow conditions, as measured by the income to expense ratio (including debt servicing costs), were firmest in the transport & storage, personal and health services and in the education industries. At the other end of the scale, conditions are under the most pressure for recreation services, finance and insurance, and other community services.

Looking at the June quarter, income slipped in 6 of the 14 industries. Over the past 12 months, topline revenue declined in all but two industries - education and agriculture. This reflects the economic slowdown induced by the battle to slay inflation.

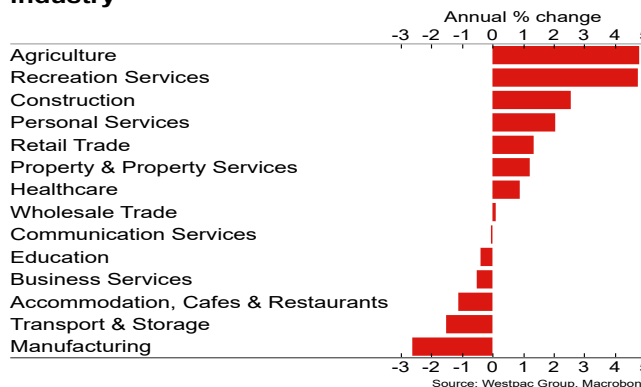
On the cost side, expense outflows are below their cycle peak in all 14 industries. However, progress has been stronger in some areas than others. Expense outflows increased in the manufacturing, retail trade and health care industries over the June quarter.

The change in the income to expense ratio was mixed across industries in the June quarter. Eight of 14 industries saw an improvement in the quarter, spearheaded by recreational services and education. Over the past 12 months, the income to expense improved in 8 of the 14 industries, led by agriculture.

Business income by industry



Income to expense (including debt costs) by industry



Preparing for the recovery

The consumer income squeeze has hit discretionary industries hard. Faced with elevated cost of living pressures, higher interest rates and a higher tax take households have pulled back where it's possible to pull back - on purchases that can be put off such as furniture, household goods and going on holidays.

This income squeeze will subside as cost-of-living measures continue to flow, including the Stage 3 tax cuts. Moderating inflation will also support household purchasing power. As incomes improve, spending on discretionary items should pick up slowly overtime, benefiting the industries that have been hit the hardest.

In addition, recently announced government budgets provide further funding for public services including education (childcare), health, housing and other community services. As this funding continues to flow, private sector providers of these services should also benefit.

Businesses ready to bring on the new year

2024-25 is shaping to be the year the economy stages a slow but steady comeback

Our business banking data shows that business cash flow conditions continued to stabilise, going sideways throughout much of the 2023-24 financial year.

Even though the economy slowed on the back of higher interest rates, businesses remained resilient by boosting cost efficiencies to protect cash flow. In fact, over the past year, the income to expense ratio (including debt servicing costs) improved in 8 of the 14 industries, led by agriculture.

In the June quarter we saw the divide between commercial businesses and SMEs increase further. Remarkably, a growing share of commercial businesses continue to see their cash flow grow, despite the slowdown in the broader economy.

We also clearly saw the foresight businesses showed to strengthen balance sheets and build buffers pay dividends.

The 2024-25 financial year is shaping to be the year the economy stages a slow but steady comeback.

But don't take our word for it.

Businesses are preparing for better times by investing in their capacity at some of the quickest rates since the start of the pandemic.

At the same time, SMEs are drawing down on credit lines to create a bridge to the other side.

Cost of living support, tax cuts, moderating inflation and eventually lower interest rates are expected to help drive the recovery in consumer demand. This will have positive flow on effects for businesses of all sizes.

There are risks, however, but businesses continue to hold firepower on their balance sheets, should it be needed.

Businesses have been a key pillar in the resilience of the Australian economy throughout the tumult of the last few years. Our data suggests that while challenges remain, armed with strong balance sheets this role can transition from a pillar of resilience to a driving force behind a recovery in economic growth.



Appendix 1: Major indicators by industry, annual % change

	Income				Expenses				Income to Expense Ratio			
	2024 YTD*	2023	2022	2021	2024 YTD*	2023	2022	2021	2024 YTD*	2023	2022	2021
By Industry												
Accommodation Cafes & Restaurants	-4.7	-1.9	12.7	10.4	-2.5	-5.7	30.7	10.2	-2.3	4.0	-13.8	0.3
Agriculture	0.9	4.7	-7.2	9.6	3.4	-0.3	3.2	13.5	-2.4	4.9	-10.1	-3.4
Business Services	-2.6	1.1	6.2	12.4	-1.3	-4.8	13.0	15.3	-1.4	6.2	-6.0	-2.5
Communication Services	0.1	-1.4	8.2	-1.6	-2.7	-9.0	8.2	9.8	2.9	8.4	0.0	-10.3
Recreation Services	-4.1	-2.9	-1.7	32.9	-1.9	-13.7	22.7	35.9	-2.2	12.6	-19.9	-2.2
Education	-3.7	12.8	8.4	6.2	1.6	11.1	13.3	10.0	-5.2	1.5	-4.3	-3.5
Healthcare	-2.4	5.1	5.8	5.2	-0.6	2.5	12.2	10.3	-1.8	2.5	-5.7	-4.6
Manufacturing	-3.6	1.2	5.1	7.1	-4.0	-1.8	10.4	7.9	0.4	3.0	-4.9	-0.8
Personal Services	4.3	0.6	9.4	8.3	0.7	2.8	16.9	8.6	3.5	-2.1	-6.4	-0.3
Retail Trade	-2.6	-2.4	6.6	0.2	-4.3	-5.7	11.2	4.7	1.7	3.5	-4.2	-4.4
Transport & Storage	-1.1	-1.3	18.9	11.8	-0.3	-3.6	23.7	21.6	-0.8	2.4	-3.8	-8.1
Wholesale Trade	-1.9	-5.2	-1.3	7.3	-2.8	-8.1	1.3	9.3	1.0	3.1	-2.5	-1.9
Construction	-2.7	3.7	12.9	8.3	-3.4	0.5	16.1	13.3	0.7	3.1	-2.8	-4.4
Property & Property Services	1.3	2.1	-0.7	12.2	6.6	-3.1	6.5	25.2	-5.0	5.4	-6.7	-10.4
By State												
NSW/ACT	-1.7	0.8	1.7	6.9	-1.6	-3.9	10.3	10.3	0.0	4.9	-7.8	-3.0
VIC/TAS	-1.8	-0.3	6.8	11.4	-3.1	-3.5	13.9	14.6	1.4	3.4	-6.2	-2.8
QLD	-0.7	1.4	6.7	9.2	-0.2	-2.6	12.2	13.3	-0.5	4.1	-4.9	-3.6
SA/NT	-4.7	2.6	6.8	10.3	-1.1	0.2	10.4	12.6	-3.6	2.4	-3.3	-2.1
WA	2.2	-1.4	2.6	12.5	-2.0	-4.4	11.9	18.6	4.3	3.1	-8.3	-5.2

*year to date percentage change



About the report

The quarterly business snapshot uses aggregated and de-identified data from our SME and Commercial business bank customers. Westpac Institutional Bank customers are not included in the scope of this report. This data provides a timely read on aggregate business conditions and the economic trends impacting small and medium businesses (including SME and Commercial businesses), providing our clients with insights to help them grow and prosper.

Turnover is derived by summing inflows paid to the accounts of the Group's business customers. Inflows related to transfers within business groups or capital transactions are excluded. Expense data is derived by summing outflows from the accounts of our business customers. Outflows related to transfers within business groups, capital transactions and outflows direct to any lending facility are excluded from the analysis. Debt servicing cost data is derived by summing the outflows from the accounts of our business customers for servicing any financing facilities or loans. It captures both interest and principal payments as applicable. Sample is adjusted where possible for changes in customer numbers. Therefore, the reported aggregates reflect the experience of the typical or average small and medium business in Australia, as opposed to changes in customer numbers. Due to data limitations, there are differences in sample groups between business cash flow data (i.e. income and expenses) and financial stock data (i.e. cash, debt, financial position). We have tried to control for these sample variations where possible.

SME businesses are those with annual turnover of less than \$5m. Commercial businesses are those with annual turnover between \$5m and \$50m.

Individual series are seasonally adjusted. All data is presented using rolling three month moving averages to smooth volatility related to the flows of income, expenses, debt servicing costs and financial stocks. Given the limited length of the time series available and volatile economic landscape over the past few years, seasonal factors are subject to change – however, different robustness methods are used to help ensure that any changes going forward are small.

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