QUARTERLY BUSINESS SNAPSHOT

Banking the cashflow increase to rebuild buffers

19 November 2024

Early signs of a recovery in conditions

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.

The Westpac business cashflow gauge improved 1.2% in the September quarter, after going sideways for much of the 2023-24 financial year. Topline business revenue continued to slide as the boost to real incomes from moderating inflation and stage 3 tax cuts has not fully flowed through to higher household spending. However, there were tentative signs of a recovery with underlying revenue (sales to final consumers) improving in the quarter after falling for much of last year.

This soft revenue outcome was more than offset by declines on the expense side. Businesses are not standing still. They are responding by adjusting what they can control: their costs. Overheads and intermediate expenses have declined over the past year supporting cashflow, and more than offsetting the growth in domestic costs.

Businesses largely saved the cashflow increase in the quarter, with deposits now growing at rates not seen since the pandemic. But they did not shy away from investing for the future, with business credit for equipment and term financing facilities continuing to grow strongly. Businesses are using their balance sheet strength to invest but are not taking on excessive risk, prudently saving for a rainy day.

Not all businesses are faring the same. The share of commercial businesses experiencing increasing cashflow has increased. The same cannot be said for SMEs where a growing share of businesses continue to experience cashflow difficulties. Businesses in the mining states or industries providing essential services continue to outperform.

While "aggregates" might be useful during normal times, they are less useful around turning points. Understanding what's happening at the micro level can provide an early indicator of future changes. The micro data suggests that the differences we are seeing across business size, location and industries will likely continue in the near term.

The worst looks to be behind us, and we expect the economy to stabilise before staging a modest recovery as we progress into 2025. Cost of living support, tax cuts, moderating inflation, and eventually, lower interest rates will support consumer spending. More demand coupled with disciplined cost control should see cashflow conditions improve for businesses of all sizes.

Cash flow insights: Conditions rebound after going sideways last year

Razor like focus on expenses supporting cashflow conditions

The Westpac business cashflow gauge improved 1.2% over the September quarter to be 1.5% higher in annual terms. This improvement was driven by easing costs pressures, particularly the costs of intermediate goods and services. Commercial businesses saw the cashflow gauge jump 2.8%qtr in September, the largest increase since the March quarter 2023.

Most of the decline in expenses has been driven by outright falls in the costs of intermediate goods and services. This includes imports from trading partners that were hard to source at anything but very elevated prices coming out of the pandemic. Growth in the costs of intermediate inputs peaked in 2022 and have come down since then, with the decline becoming more pronounced in the second half of 2023.

Eleven of the thirteen industries have seen costs come down over the past year.

12-month change:

–2.6% Income

–3.9% Expenses

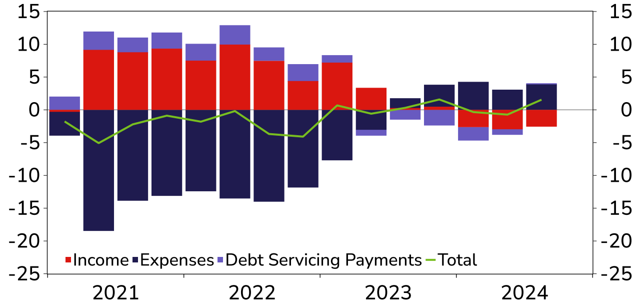
–5.2% Debt servicing costs

Domestic costs pressures remain elevated but here too we are seeing positive signs. Labour costs, the main component of the underlying domestic cost base, have increased 8.% in annual terms, but have eased more recently, falling by around 2.0% over the September quarter. Some of this is likely to have resulted from the slowdown in hours worked outside the non-market sector of the economy.

There are some positive signs on the revenue side of the ledger as well. Underlying revenue (revenue from sales to final consumers) has stabilised after easing for much of the past year. Other sources of revenue, including interest returns and rental income, continue to moderate.

Income to expense ratio

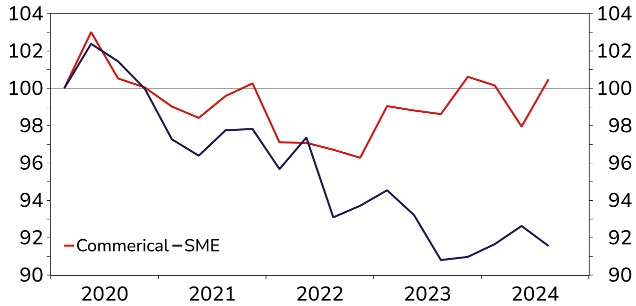
Including debt servicing, Cont. to annual change



Source: Macrobond, Westpac Economics

Income to expense ratio by size

Including debt servicing, Index: March 2020 = 100



Source: Macrobond, Westpac Economics

Focus on technology to pay off

Higher interest rates, a growing tax take and elevated inflation have squeezed household income, leading to outright falls in per capita spending. In this environment businesses have focused on what they can control: their costs.

Since reaching a peak in 2022, the costs of intermediate inputs have fallen by close to 25%. This in part reflects a moderation in inflationary pressures and growth in activity, but also costs containment measures businesses have put in place.

Reducing overheads, negotiating better deals from suppliers and investing in productivity enhancing technology have all helped. Feedback from clients point to a changing investment mix, with greater focus on technology, software and R&D to improve efficiency.

This is consistent with ABS data which showed for the first time ever businesses are investing more in intangibles (such as software and R&D) than in other more traditional forms of capital items such as new commercial buildings (industrial, office, retail). As new technology flows through business processes and practices, businesses will become more efficient further helping to contain costs.

Balance sheet insights: Financial strength continues to be well above pre pandemic

Businesses are using their balance sheets to invest

The improved cashflow in the September quarter was largely banked and used to help maintain financial strength. Business deposits increased 2.3% over the September quarter to be up 5.6% in annual terms – the strongest annual and quarterly increase since the pandemic. In fact, deposits per business is close to its highest on record, also increasing over the quarter. The liquidity boost was concentrated in commercial businesses, where total deposits increased by 2.7% over the September quarter. SMEs on the other hand saw a much more moderate increase of just 0.9%qtr.

But businesses did not shy away from investing. Business credit grew strongly, by 3.1% over the quarter. It appears businesses are looking to build liquidity and save for a rainy day while also using their balance sheets to invest. Commercial businesses continue to rely on equipment and term financing facilities to ramp up capacity – over the past year, equipment financing has grown at more than double the rate of growth in working capital. SMEs on the other hand continue to rely on working capital to support cashflow. Both sets of businesses have significant headspace in their credit lines, with credit utilisation below pre pandemic levels in the commercial space and slightly above pre pandemic levels for SMEs.

Overall, the Westpac business debt coverage gauge eased 0.8% over the September quarter to be 3.6% lower in annual terms. Notwithstanding this decline, aggregate balance sheet strength continues to be well above pre pandemic levels. The gauge was unchanged for commercial businesses but declined 2.8% for SMEs.

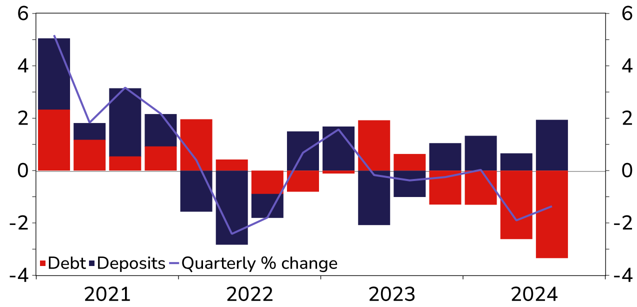
The Westpac business debt coverage gauge remains 25% above pre pandemic levels.

Measuring balance sheet strength:

Our debt coverage gauge assesses the stock of cash relative to businesses' financial liabilities.

Business debt coverage gauge

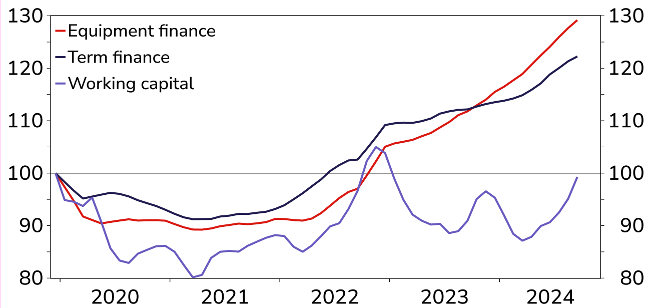
Contribution to quarterly change



Source: Macrobond, Westpac Economics

Commercial business debt by type

Index March 2020 = 100



Source: Macrobond, Westpac Economics

Businesses providing essential services are outperforming

While the aggregate Westpac business debt coverage gauge deteriorated in the quarter, the experience was not uniform across industries.

There were improvements in those industries providing essential services to the growing population, including education, healthcare, social services and property services.

These industries saw credit and investment grow, which was more than offset by increases in liquid assets, most notably deposits. Businesses in these industries have increased term and equipment financing, while the use of working capital facilities has remained low.

On the other hand, some of the industries at the coal face of the consumer led slowdown saw falls in the debt coverage gauge.

Businesses in these industries are drawing on their cash stockpiles to manage more challenging cashflow conditions. This includes retail and wholesale, accommodation, cafes and restaurants and recreational services.

A look under the 'aggregates': Commercial businesses outperform

Smaller businesses more likely to face cashflow difficulties; conditions vary across states

While 'aggregates' might be useful during normal times, they are less useful around turning points. Understanding what's happening at the micro level can provide an early indicator of future changes to the aggregates.

We find that a growing share of commercial businesses have recorded above average growth in their cashflow, despite the economic challenges impacting the economy. The share has now increased for ten consecutive quarters, showing that commercial businesses have managed to effectively weather the economic headwinds.

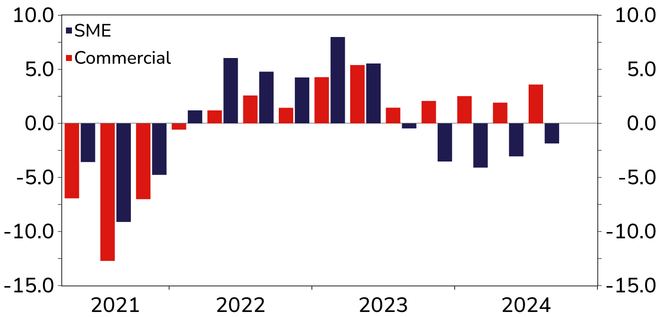
In stark contrast, SMEs are finding it harder to pass on higher costs and this is being reflected in their cashflow conditions. A larger share of smaller businesses continues to experience cashflow difficulties and are relying on their financial buffers to build a bridge to the expected pick-up in spending. On a positive note, share of SMEs with improving cash flows looks to be stabilising.

Turning to the states, the share of businesses experiencing improving cashflow continues to grow in the mining states, while flatlining in the non-mining states, but but still ticking higher. In addition, the number and share of businesses experiencing cashflow difficulties is falling in the mining states, while remaining broadly unchanged in the non-mining states.

The micro data suggests that the differences we are seeing across geographical location will likely continue in the near term, with only tentative signs of a pickup in cashflow conditions outside of the mining states.

Share of businesses with improving cash flow

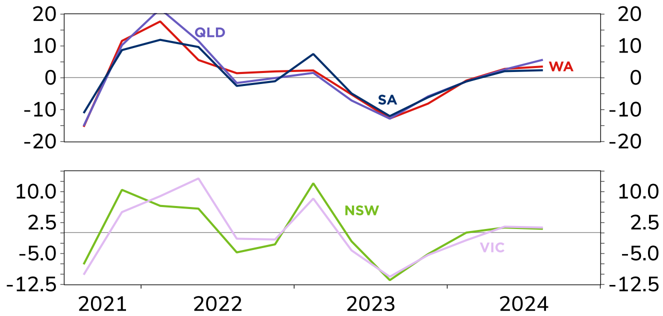
Percentage point deviation from average, Rolling 6-month average



Source: , Macrobond, Westpac Economics

Share of businesses with improving cash flow

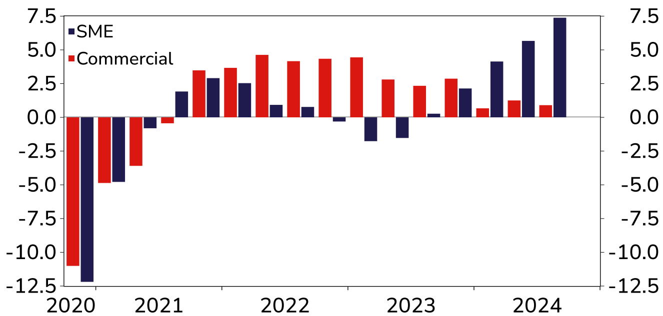
Rolling 6-month percentage point change



Source: , Macrobond, Westpac Economics

Share of cash flow constrained businesses

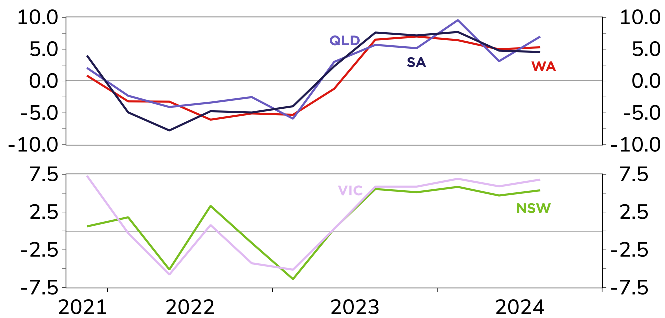
Percentage point deviation from average, Rolling 12-month average



Source: , Macrobond, Westpac Economics

Share of cash flow constrained businesses

Rolling 12-month percentage point change



Source: , Macrobond, Westpac Economics

Industry insights: Business providing essential services continue to outperform

Broad based moderation in costs pressures

There has been a broad-based moderation in cost pressures across industries. Nine of the thirteen industries saw their expenses fall over the September quarter. Across the past year, eleven of the thirteen industries saw their costs come down.

This moderation has been more pronounced in those industries that are less labour intensive such as retail and wholesale trade, with more modest declines seen in labour intensive industries such as education and healthcare. Costs pressures will likely moderate further, particularly as the labour market softens and wages growth eases, consistent with recent labour market outcomes.

Revenue is a different story. Looking at the September quarter, income grew in four of the thirteen industries. Those industries providing essential services for the growing population have fared better with income remaining more resilient. This includes education, health and professional services, and property services (including real estate management).

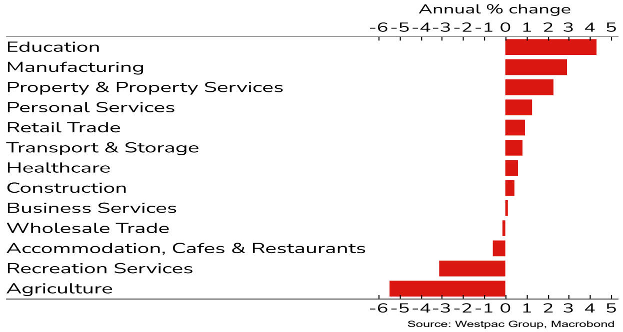
Those industries in the discretionary part of the economy (retail/ wholesale, accommodation, cafes and restaurants, and cultural/ recreational services) continue to do it tough, with revenue falling fastest in the retail and wholesale trade, and transport and storage industries.

The change in the income to expense ratio (including debt servicing costs) was mixed across industries in the September quarter. Five of the thirteen industries saw an improvement in the quarter, spearheaded by manufacturing, education and property services.

Over the past 12 months, the income to expense improved in nine of the thirteen industries, led by education.

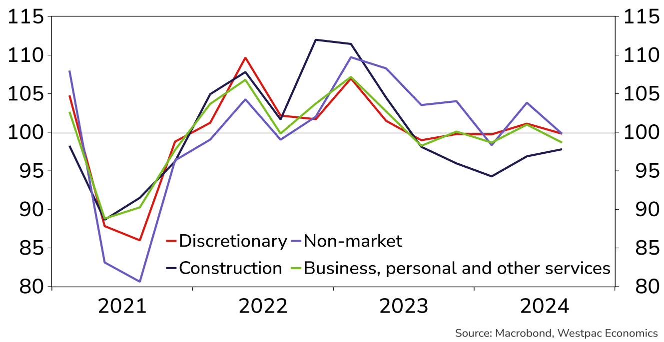
Relative to pre-pandemic levels, cashflow conditions, as measured by the income to expense ratio (including debt servicing costs), were firmest in the education, personal services, manufacturing and property services industries.

Income to expense (including debt costs) by industry



Share of businesses with improving cash flow

Index: Average over sample = 100



Industry divergence to remain in the near term

The micro level data suggests that the differences we are seeing across industries will likely continue in the near term. There are only tentative signs cashflow conditions are converging across the different industries.

The share of businesses recording improved cashflow in the non-market sector (health, education and social service industries) has ticked higher, with the share of businesses experiencing cashflow difficulties also easing over the past few quarters.

In the discretionary and the broader services (business services and personal and other services) parts of the economy, the share of businesses recording increasing cashflows has stabilised after falling through much of 2023.

Cashflow conditions in the construction industry remain challenging but have improved over the past two quarters, with the share of businesses recording improved cashflow ticking higher since March 2024. The share of businesses experiencing cashflow difficulties peaked in the March quarter 2024 and has ticked lower over the past two quarters.

A look from coast to coast:
Economy and cashflow conditions running at two speeds

Mining states are outperforming

Our previous research has shown that WA is leading the pack on key economic metrics including growth in state demand, retail trade, labour market conditions and fiscal outcomes (see here). On these metrics, Queensland is a distant second, but the gap is narrowing as the Queensland Government's cost of living measures kick in and the "Queensland's Big Build" infrastructure program gathers momentum.

This divergence in economic performance has flowed through to business cashflow conditions, which has varied considerably across states.

Cashflow conditions as measured by the income to expense ratio (including debt servicing costs) in WA and Queensland are running ahead of the pack, with SA making up some growth over the past few quarters. Cashflow conditions in NSW and Victoria remain well below pre pandemic levels.

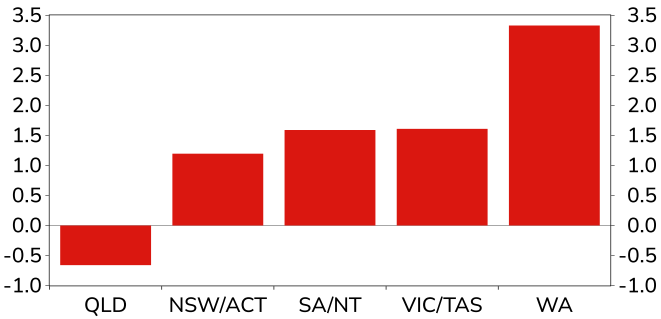
Over the past year cashflow conditions have improved by 3.3% in WA, 1.6% in Victoria and South Australia, 1.2% in NSW, while falling in QLD by around 0.6%. Notwithstanding the decline in QLD, cashflow levels remain elevated compared to the other states.

Over the year to the September quarter, business income increased 1.4%yr in WA and was flat in Queensland. The other states recorded falls, including Victoria (-2.2%yr), NSW (-3.5%yr) and SA (-3.6%yr). On the other side of the budget, costs have fallen by 4.6%yr in Victoria and SA, 4.0% in NSW, 1.6%yr in WA and 0.2% in QLD.

The micro level data shows only tentative signs cashflow conditions are converging across the different states.

Income to Expense Ratio by State

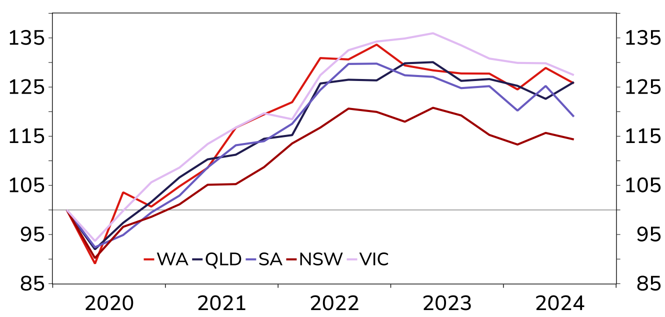
Including Debt Servicing Payments, Annual % Change



Source: , Macrobond, Westpac Economics

Business Expenses by State

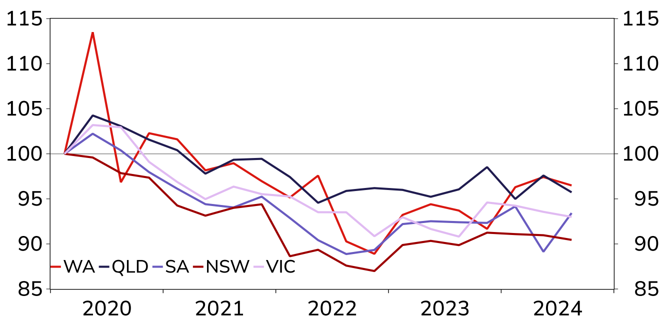
Rolling 3-month Sum, Index March 2020 = 100



Source: , Macrobond, Westpac Economics

Income to Expense Ratio by State

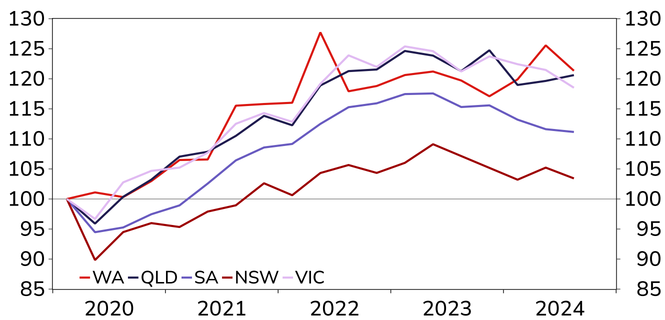
Including Debt Servicing Payments, Index March 2020 = 100



Source: , Macrobond, Westpac Economics

Business Income by State

Rolling 3-month Sum, Index March 2020 = 100



Source: , Macrobond, Westpac Economics

Well-placed to benefit from the stronger economy

Early signs the economy is staging a comeback

Our business banking data shows that cashflow conditions improved in the September quarter, after going sideways for much of the previous year.

Even though the economy has slowed on the back of higher interest rates, businesses are not standing still. They are responding by adjusting what they can control: their costs. As a result, over the past year, the income to expense ratio (including debt servicing costs) improved in nine of the thirteen industries.

Businesses largely saved the cashflow increase in the September quarter, but did not shy away from investing for the future, with credit for equipment and term financing facilities continuing to grow strongly.

Our data also shows that the divergence in performance across business size, state lines and industries continued over the quarter.

But there is much to be optimistic about.

Underlying sales stabilised in the September quarter after falling for much of the past year.

Tax cuts and moderating inflation are helping to ease the squeeze on household incomes. At this stage there are only early signs that this is flowing through to higher spending. The time it will take for these early signs to evolve into a broad-based recovery remains uncertain.

What is much more certain is that businesses continue to do the hard work to bring down costs and improve efficiency. This has placed the sector and businesses of all sizes in a great position to thrive when spending lifts.

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 back to trend 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	-0.6	-1.9	12.7	10.5	3.1	-5.7	30.8	10.2	-3.6	4.0	-13.8	0.3
Agriculture	-2.0	4.7	-7.2	9.6	2.8	-0.3	3.2	13.5	-4.7	4.9	-10.1	-3.4
Business Services	-4.5	1.1	6.2	12.4	-1.1	-4.8	13.0	15.3	-3.5	6.2	-6.0	-2.5
Recreation Services	-0.5	-2.9	-1.7	32.9	6.4	-13.8	22.8	35.8	-6.5	12.7	-19.9	-2.1
Education	0.1	12.8	8.4	6.2	-2.2	11.0	13.3	10.0	2.3	1.6	-4.3	-3.5
Healthcare	-4.2	5.1	5.8	5.2	-4.4	2.5	12.2	10.2	0.2	2.5	-5.7	-4.6
Manufacturing	-1.9	1.2	5.0	7.0	-2.9	-1.8	10.4	7.9	1.0	3.0	-4.9	-0.8
Personal Services	4.4	0.6	9.4	8.3	0.5	2.8	16.9	8.6	3.8	-2.1	-6.4	-0.3
Retail Trade	-4.0	-2.4	6.6	0.2	-3.1	-5.7	11.2	4.7	-1.0	3.5	-4.2	-4.4
Transport & Storage	-0.5	-1.3	18.9	11.7	-2.4	-3.6	23.7	21.6	1.9	2.4	-3.8	-8.1
Wholesale Trade	-6.7	-5.2	-1.3	7.3	-6.0	-8.1	1.3	9.3	-0.8	3.1	-2.5	-1.9
Construction	-4.1	3.6	12.9	8.3	-4.2	0.5	16.1	13.3	0.1	3.1	-2.8	-4.4
Property & Property Services	-2.4	2.1	-0.7	12.2	-4.9	-3.1	6.5	25.2	2.6	5.4	-6.7	-10.4
By State												
NSW/ACT	-1.7	0.8	1.7	6.9	0.6	0.8	0.8	0.8	-0.9	4.9	-7.8	-3.0
VIC/TAS	-4.2	1.4	6.7	9.2	-0.8	-3.9	10.3	10.3	-1.7	4.1	-4.9	-3.6
QLD	-3.3	2.6	6.8	10.3	-2.6	-2.6	12.2	13.3	-2.8	2.4	-3.3	-2.1
SA/NT	-3.8	-0.3	6.8	11.4	-0.5	0.2	10.4	12.6	1.2	3.4	-6.2	-2.8
WA	3.6	-1.4	2.6	12.5	-5.0	-3.5	13.8	14.6	5.3	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.

www.westpaciq.com.au/economics

Economics@westpac.com.au

Authors

Westpac Economics

Pat Bustamante

M: +61 434 856 909

E: pat.bustamante@westpac.com.au

Jameson Coombs

M: +61 401 102 789

E: jameson.coombs@westpac.com.au

Data Science and Innovation

Norman Yan

Service Owner

Credit Analytics Management, Business Lending

David Millar

Executive Manager

Georgiy Lytvynenko

Senior Manager

Long San Wong

Senior Manager

Corporate directory

Westpac Economics / Australia

Sydney
Level 19, 275 Kent Street
Sydney NSW 2000
Australia

E: economics@westpac.com.au

Luci Ellis
Chief Economist Westpac Group
E: luci.ellis@westpac.com.au

Matthew Hassan
Head of Australian Macro-Forecasting
E: mhassan@westpac.com.au

Elliot Clarke
Head of International Economics
E: eclarke@westpac.com.au

Justin Smirk
Senior Economist
E: jsmirk@westpac.com.au

Pat Bustamante
Senior Economist
E: pat.bustamante@westpac.com.au

Mantas Vanagas
Senior Economist

E: mantas.vanagas@westpac.com.au

Ryan Wells
Economist
E: ryan.wells@westpac.com.au

Illiana Jain
Economist
E: illiana.jain@westpac.com.au

Jameson Coombs
Economist
E: jameson.coombs@westpac.com.au

Neha Sharma
Economist
E: neha.sharma1@westpac.com.au

Westpac Economics / Fiji

Suva
1 Thomson Street
Suva, Fiji

Shamal Chand
Senior Economist
E: shamal.chand@westpac.com.au

Westpac Economics / New Zealand

Auckland
Takutai on the Square
Level 8, 16 Takutai Square
Auckland, New Zealand

E: economics@westpac.co.nz

Kelly Eckhold
Chief Economist NZ

E: kelly.eckhold@westpac.co.nz

Michael Gordon
Senior Economist
E: michael.gordon@westpac.co.nz

Darren Gibbs
Senior Economist
E: darren.gibbs@westpac.co.nz

Satish Ranchhod
Senior Economist
E: satish.ranchhod@westpac.co.nz

Paul Clark
Industry Economist
E: paul.clark@westpac.co.nz

IQ
westpaciq.com.au

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