

Subdued SME conditions trigger a drop in confidence

- Business confidence of SMEs weakened sharply in the June quarter, consistent with the deterioration in confidence reported by larger businesses in the NAB Quarterly Business Survey. At an aggregate level, SMEs are less optimistic than larger firms. The high Australian dollar, cautiousness of households and concerns about the global outlook are likely to have contributed to the decline in sentiment. The survey preceded the announcement of the carbon tax. SME business conditions were unchanged at a subdued level, although remain broadly in line with conditions reported by larger firms.
- The most significant falls in business confidence were reported in property, construction, finance and retail, while confidence in health and business services improved. Retail sentiment is now the weakest of all industries, while confidence is strongest in business services. Confidence levels fell across all major states, with SA reporting the lowest level of confidence, followed by NSW and Queensland. WA and Victoria are the most optimistic about near-term activity, although confidence even in these states is relatively poor.
- Property and business services recorded the largest decline in business conditions, while in contrast, conditions improved in construction and manufacturing. Conditions were strongest in health services and finance, and weakest in property and transport. By state, conditions fell sharply in SA, followed by WA, and improved in Queensland and NSW. Despite improving solidly in the quarter, conditions in Queensland remained the most subdued of all mainland states, while conditions were strongest in Victoria and NSW.
- Confidence levels fell to uniformly weak levels across all firm sizes. Conditions were also relatively subdued across SMEs; conditions improved for low-tier (turnover of \$2-3m p.a.) and high-tier (\$5-10m p.a.) firms reflecting improvements in profitability and employment, while conditions of mid-tier firms (\$3-5 m p.a.) softened.
- Consistent with general weakness in business conditions, cash flow deteriorated in the June quarter, especially in transport, wholesale, property and business services, while cash flows improved most in health services. Cash flows were weaker across all states in the June quarter, with the exception of Queensland where they improved solidly.
- Employer's long-term decisions continue to be constrained by a general lack of demand, while tax & government policy and global economic uncertainty were perceived to be more constraining factors in the June quarter.

Key quarterly business statistics**

| | 2010q2 | 2011q1 | 2011q2 | | 2010q2 | 2011q1 | 2011q2 |
|-------------------------|--------------------|--------|--------|------------------------|--------------------|--------|--------|
| | <i>Net balance</i> | | | | <i>Net balance</i> | | |
| SME business confidence | 6 | 8 | 0 | SME trading conditions | 13 | 1 | 0 |
| Low | 4 | 8 | 1 | Low | 10 | -1 | -1 |
| Mid | 5 | 10 | 0 | Mid | 6 | 6 | 2 |
| High | 7 | 7 | 0 | High | 18 | -2 | -1 |
| SME business conditions | 8 | -2 | -2 | SME profitability | 4 | -6 | -3 |
| Low | 6 | -7 | -4 | Low | 5 | -10 | -6 |
| Mid | 4 | 6 | 2 | Mid | -1 | 3 | 0 |
| High | 11 | -5 | -3 | High | 8 | -11 | -5 |
| SME cash flows | 7 | -1 | -5 | SME employment | 6 | -1 | -1 |
| Low | 1 | -1 | -9 | Low | 3 | -9 | -5 |
| Mid | 6 | 1 | -6 | Mid | 6 | 8 | 2 |
| High | 10 | -2 | -3 | High | 7 | -3 | -2 |

Low: \$2-3m p.a. Mid: \$3-5m p.a. High: \$5-10m p.a.

** All data not seasonally adjusted, except SME business confidence, which has been seasonally adjusted by NAB. All data are net balance indexes. Fieldwork for this Survey was conducted from 23 May to 8 June 2011, covering over 687 SME firms across the non-farm business sector.

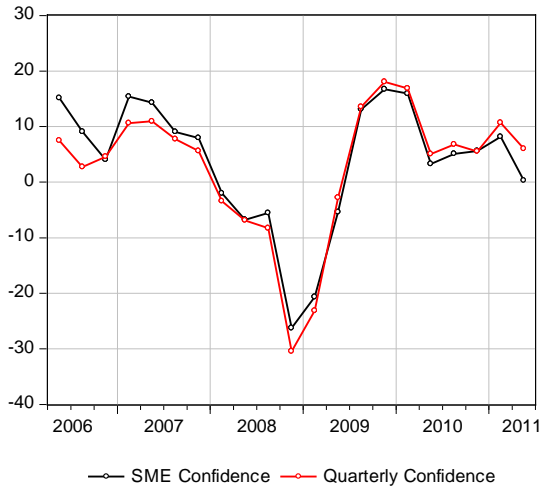
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Next release:
 9 August (July Monthly)

Analysis

Confidence unwound

Business confidence (net bal., s.a.), SME & quarterly



Conditions still weak

Business conditions (net bal.), SME & quarterly

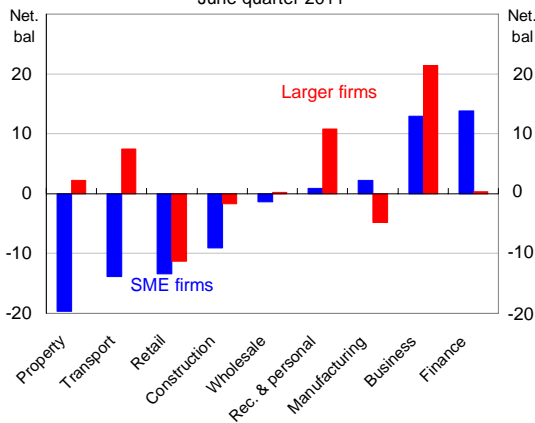


SME business confidence (seasonally adjusted) deteriorated sharply in the June quarter, consistent with the fall in confidence reported by larger businesses in the NAB Quarterly Business Survey. The fall in confidence more than unwound the gradual improvement in confidence over the previous three quarters. The high Australian dollar, continued cautiousness of households and concerns about the global outlook are likely to have contributed to the decline in sentiment in the quarter. The fall in confidence was broad-based across low to high tier SMEs, and was more pronounced for SMEs than it was for larger businesses.

SME business conditions were unchanged in the June quarter and remained closely aligned with larger businesses. Overall, conditions remain weak and poor.

SME property services outperform larger firms; SME finance strong

Business conditions
June quarter 2011

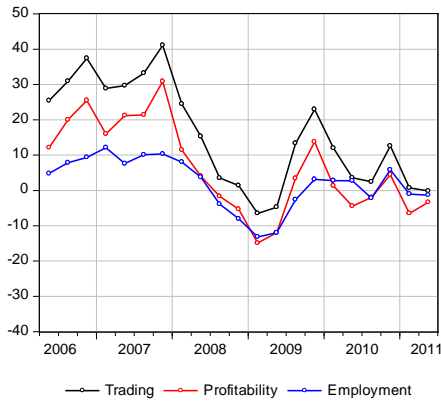


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that larger firms outperformed SMEs across all industries, with the exception of finance, where SMEs experienced particularly favourable conditions, and manufacturing, where SME conditions were marginally expansionary. Conditions for SME property services were particularly weak compared to their larger counterparts, while SME transport firms experienced more difficult conditions than larger transport firms. A consistent feature across all firms, regardless of size, is the persistent weakness in retail and strength in business services.

Analysis (cont.)

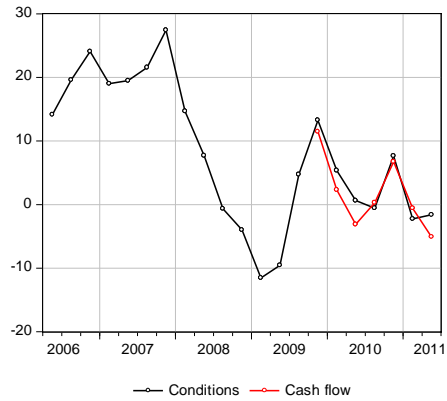
Profitability up, but still subdued

SME business conditions components (net bal.)



Cash flow deteriorates

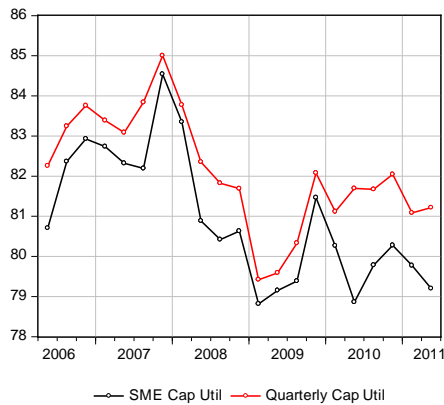
SME business conditions & cash flow (net bal.)



SME business conditions were unchanged in the quarter reflecting a marginal decline in trading conditions offset by an improvement in profitability. SME cash flows continued to deteriorate and are now at the weakest level recorded in the (very short) history of the series.

Capacity utilisation lower

Capacity utilisation (per cent), SME & quarterly



Orders deteriorate further

Forward orders (net bal.), SME & quarterly



Capacity utilisation fell for a second consecutive quarter, with the gap between SME and larger business capacity utilisation beginning to open up again. SME's forward orders continued to weaken and remain less favourable than orders for larger firms.

Stocks levels contract

Stocks (net bal.), SME & quarterly



SMEs invest less than larger firms

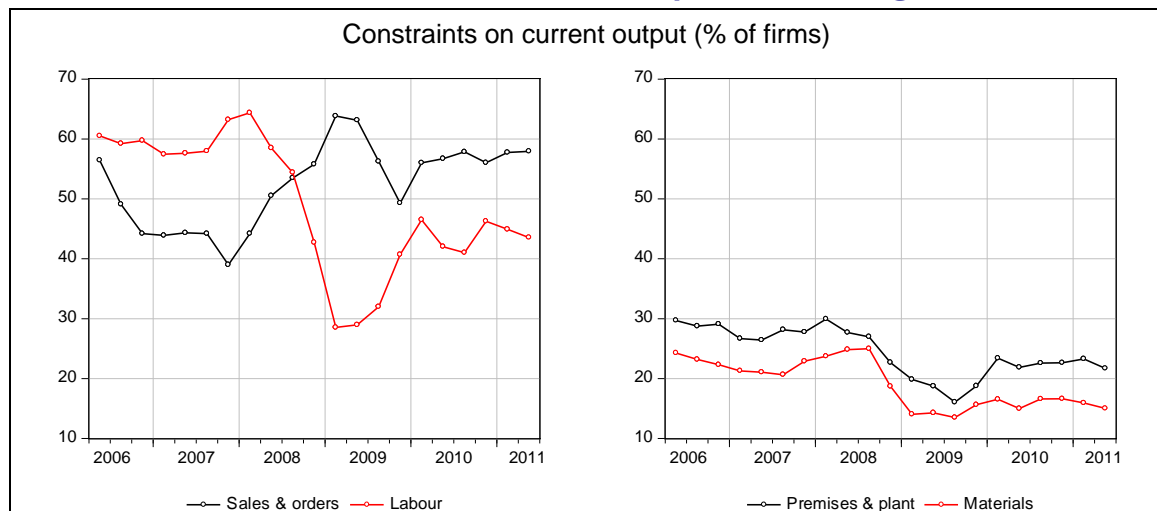
Capital expenditure (net bal.), SME & quarterly



SME stocks continued to move broadly in line with those of larger firms in the June quarter, although overall, stocks just remain in negative territory. The surveys imply that larger firms are investing more than SMEs, which likely reflects strength in mining (not captured by the SME survey). Nonetheless, capital expenditure by SMEs remained in positive territory.

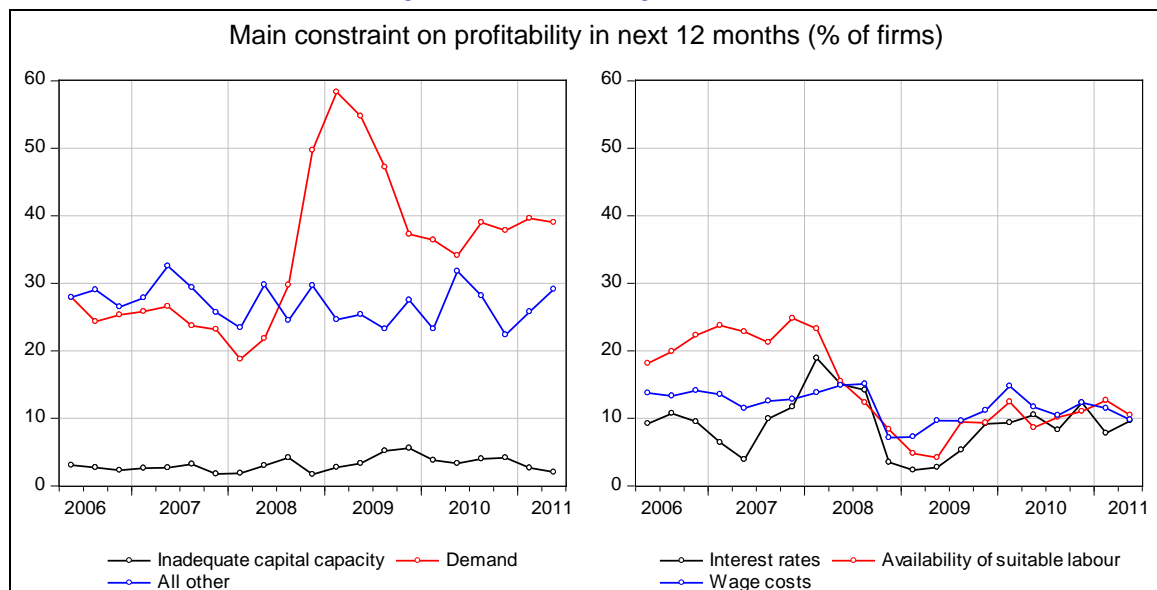
Analysis (cont.)

Labour less of a constraint on output, but still significant



Sales & orders was the most constraining factor on output in the June quarter but it was broadly unchanged in terms of significance. SMEs reported the availability of suitable labour as less of a constraint on output, which was in contrast to the experience of larger firms where labour availability has increased as a constraint over recent quarters. The proportions of SMEs reporting premises and materials as constraints were a little lower and their relative importance is broadly similar to those of larger firms.

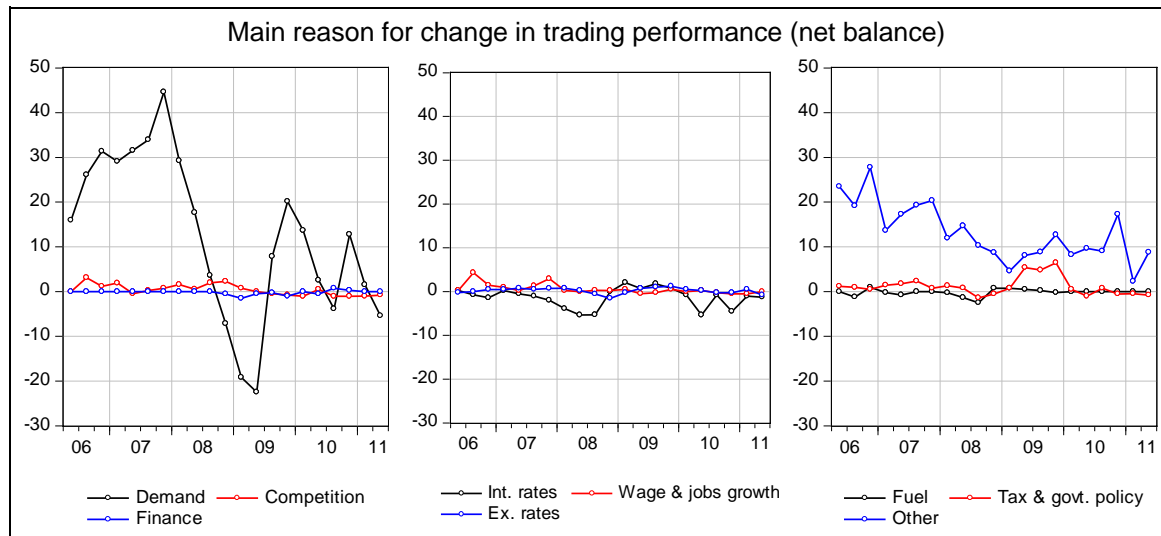
Profitability constrained by a lack of demand



Future SME profitability continues to be constrained by a lack of demand, and the significance of this constraint remains well above pre-GFC levels. The importance of interest rates on profitability increased, while capital capacity, wage costs and the availability of suitable labour were all perceived to be slightly less important than in the previous quarter. These results are similar to those for larger firms. Under “all other” factors, higher fuel and utility costs were commonly cited as a constraint on future profitability by SMEs in transport, while weather conditions were seen as an issue by SMEs in manufacturing, finance & insurance and construction.

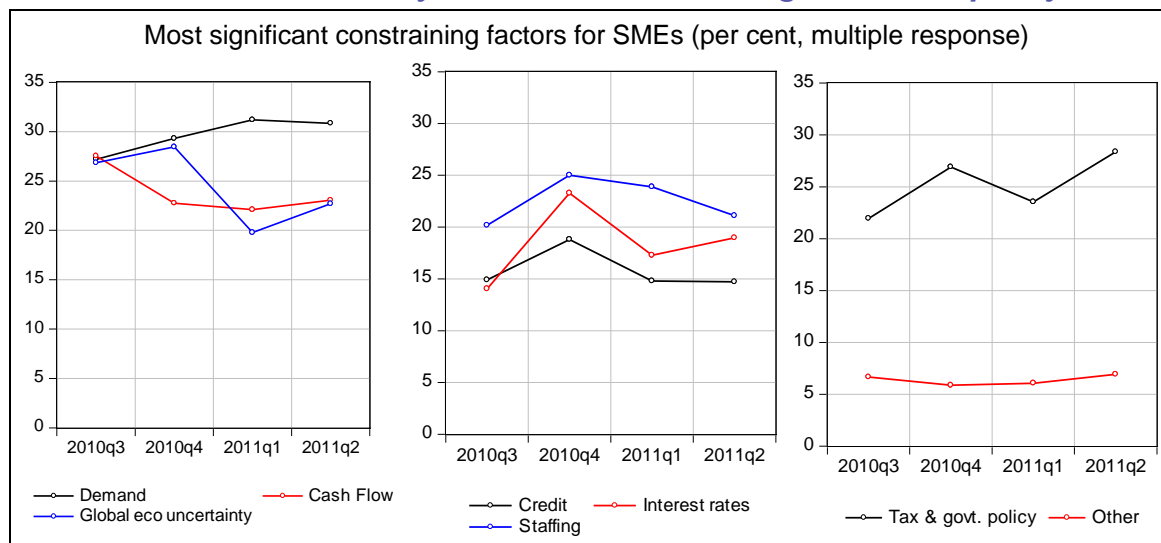
Analysis (cont.)

Demand less significant as a driver of trading performance



Consumer demand became less significant as a driver of trading performance in the June quarter, while other factors affecting trading were largely neutral. In contrast, “other” factors became relatively more important, with many respondents noting that “weak economic conditions” and the lingering “impact of the floods” had affected trading performance.

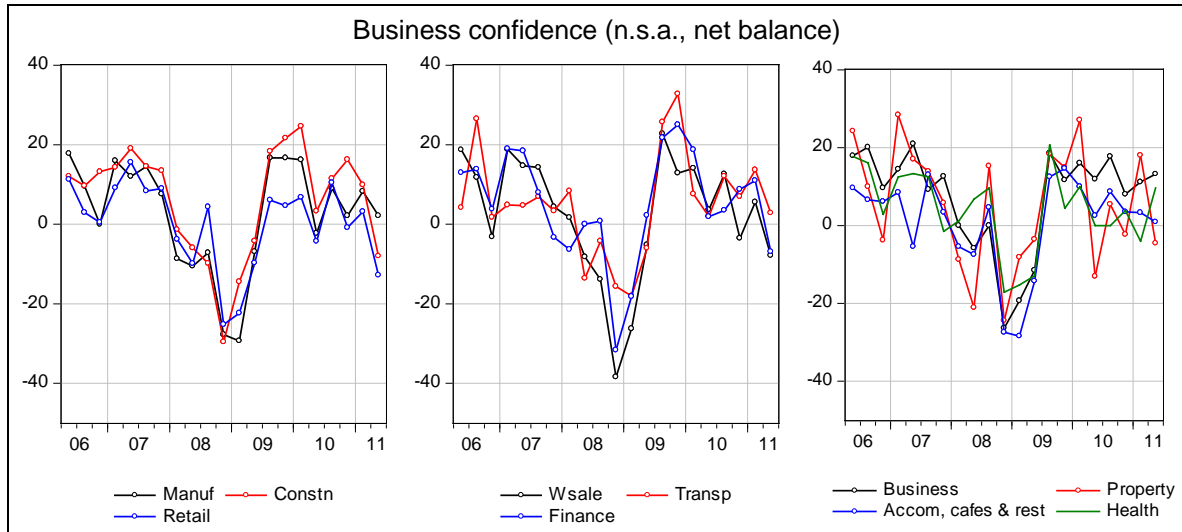
SMEs constrained by a lack of demand and government policy



Demand was again the most significant constraining factor for a majority of firms in the June quarter. Tax & government policy increased in significance, which may have reflected anticipation of the carbon policy announcement (made after the survey was conducted). Global economic uncertainty was more of a constraining factor in the June quarter. Interest rates also became more of a constraint; however businesses perceived them, as well as availability of credit, to be relatively minor overall.

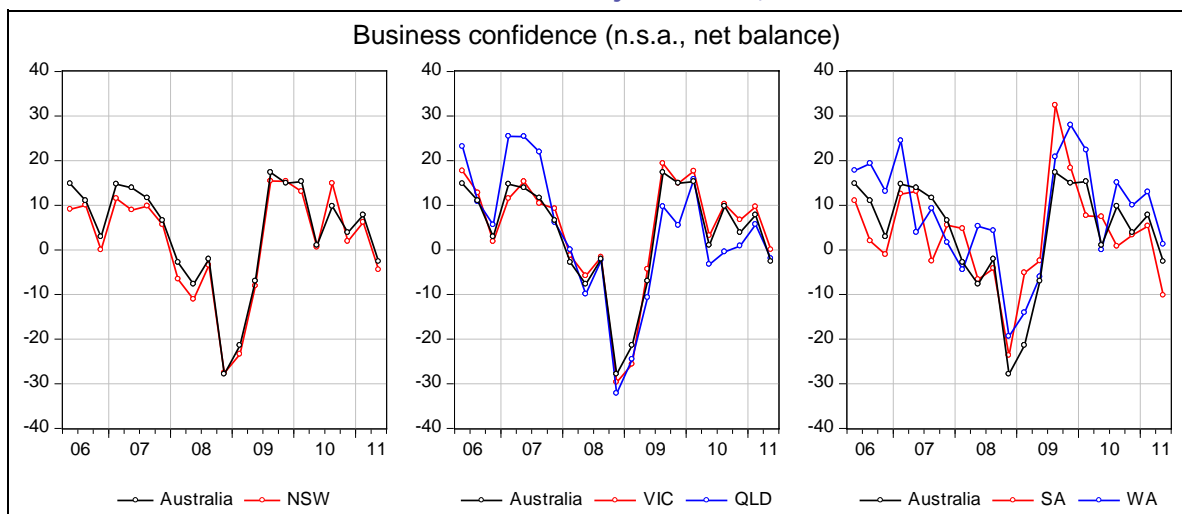
Industry and State analysis

Business and health confident; retail pessimistic



Business confidence (non-seasonally adjusted) deteriorated sharply across a majority of industries in the June quarter, with expected business conditions now contracting in half of all reporting industries. The most notable deterioration in confidence was in property services (down 23 points to -5 points), followed by construction and finance (both down 18 points). Confidence also deteriorated sharply in retail, where it is now the weakest (-13). In contrast, confidence rose solidly in health services and also improved in business services, where it is now highest (+11).

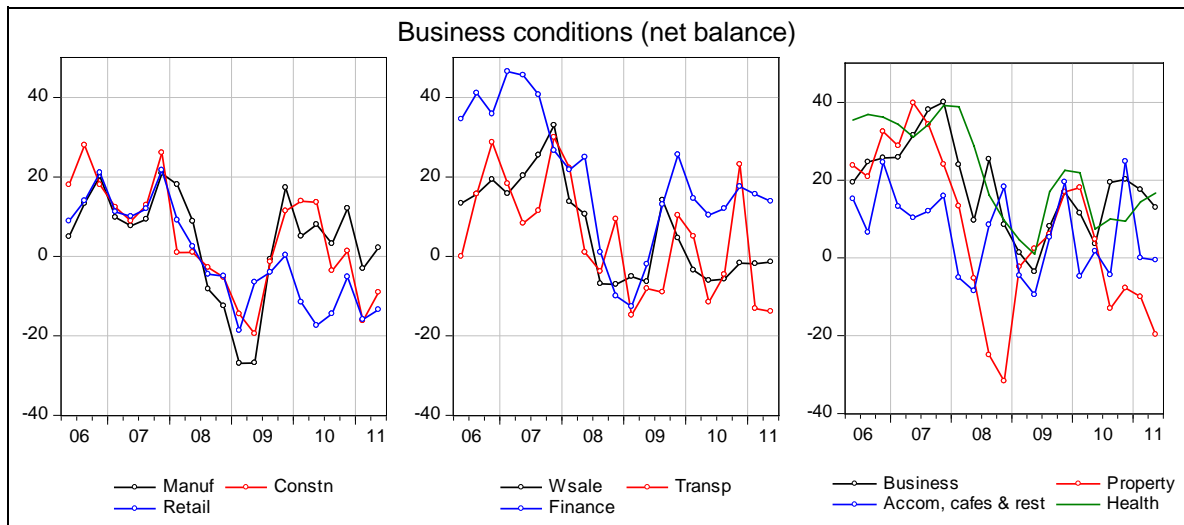
Business confidence lower for all major states; weakest in SA and NSW



Business confidence levels deteriorated across all major states in the June quarter, after rising (to a lesser extent) across all major states in the previous quarter. Confidence levels fell most significantly in SA, where they are also the weakest (-10), followed by WA, NSW and Victoria. WA is now the only mainland state expecting conditions to improve in the near term, albeit only slightly.

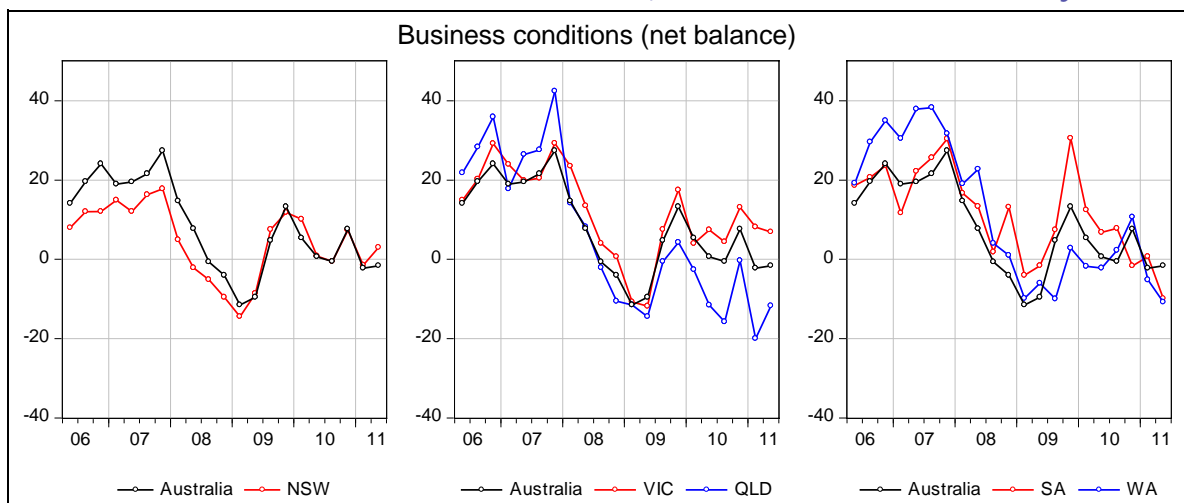
Industry and State analysis (cont.)

Business conditions in health outperform; property and transport weak



Movements in business conditions were mixed across industries in the quarter, although a majority of industries recorded an overall contraction in conditions. Conditions deteriorated sharply in property services, where they are very weak and poor, and conditions also softened in business services and finance. In contrast, conditions improved in health services, where they were strongest, as well as in construction, manufacturing and retail.

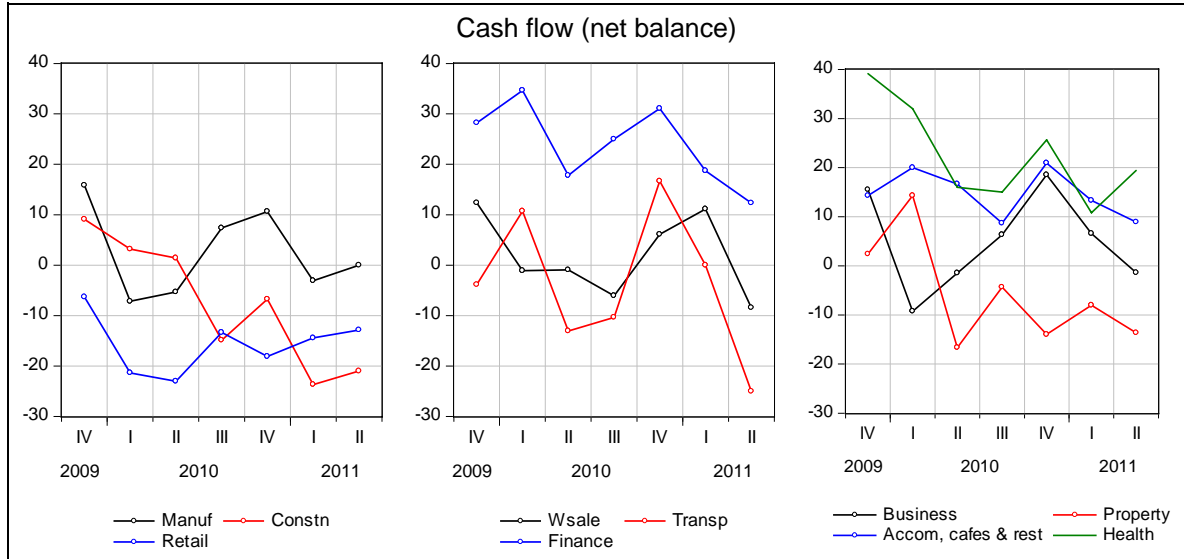
Conditions recover in QLD but still weak; conditions in VIC relatively solid



Business conditions were mixed across states in the June quarter. Despite improving solidly, conditions in Queensland remained the weakest of all mainland states, with the impact of the floods evidently still impacting upon day-to-day business operations. Business conditions also picked up in NSW. In contrast, conditions fell sharply in SA and WA, and were a little softer in Victoria, where they were strongest.

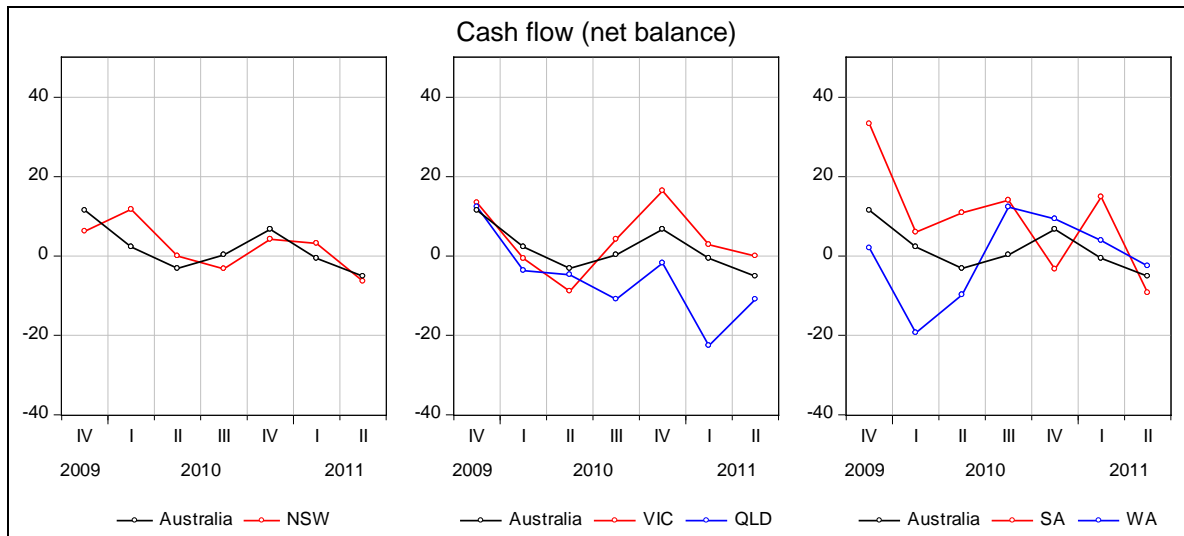
Industry and State analysis (cont.)

Cash flows strong in health, weak transport and construction



Cash flow deteriorated most notably in transport, reflecting the rise in fuel prices in the quarter. Cash flows were also weaker in wholesale, property and business services and accommodation. Consistent with an improvement in conditions, cash flows were strong in health services, and were also a little healthier in manufacturing, construction and retail. Cash flows are now the strongest in health services and weakest in transport and construction.

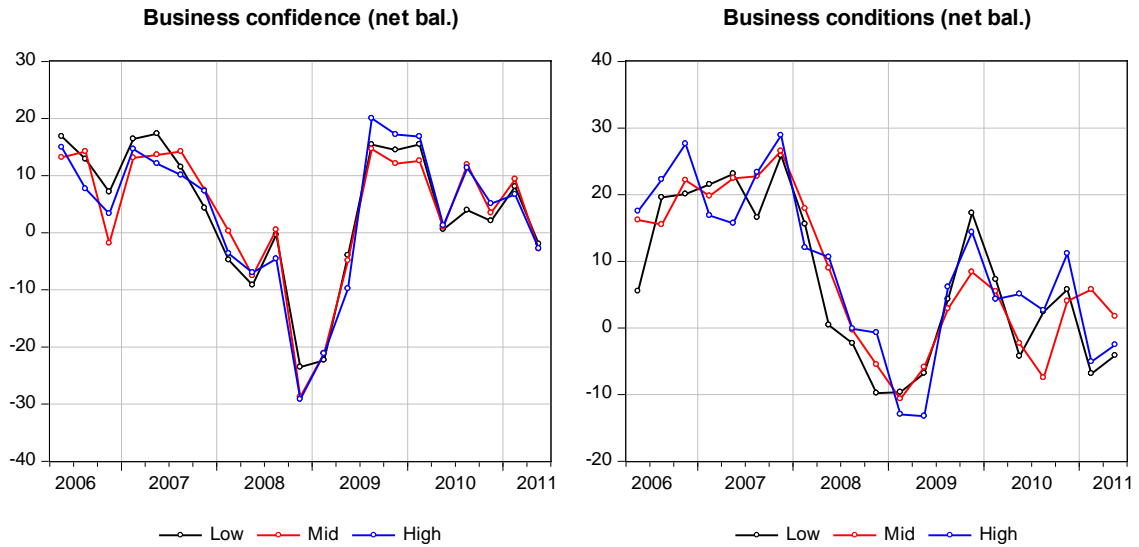
Cash flows deteriorate across all States except QLD



Cash flows were weaker across all states in the June quarter, with the exception of Queensland where they improved solidly. The most significant deterioration in cash flow was reported in SA followed by NSW. Cash flow indices are now highest in Victoria and WA, and lowest in Queensland and SA.

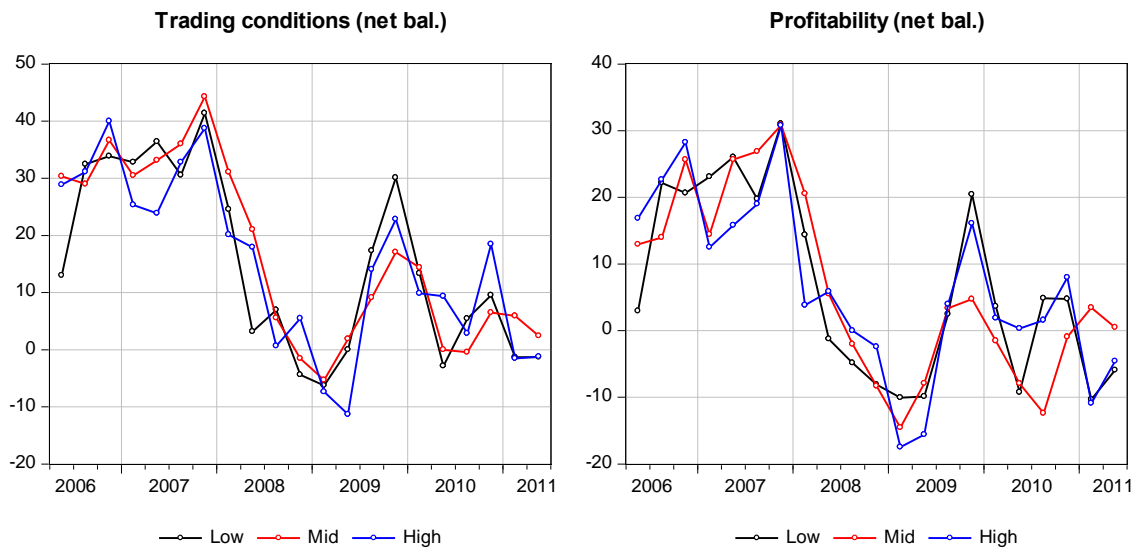
Firm size analysis

Mid-tier firms outperform low- and high-tier firms, but confidence subdued for all SMEs



Business confidence deteriorated across all SMEs in the quarter, with confidence levels across all SMEs broadly similar at a slightly contractionary level. There remained some variation in business conditions across SMEs, with mid-tier firms (\$3-5m p.a.) continuing to report more favourable conditions than low (\$2-3m p.a.) and high (\$5-10m p.a.) tier firms. This was despite a softening in mid-tier firm conditions, and improvements in low- and high-tier firm conditions. The improvement in conditions for low- and high-tier firms reflected a general improvement in profitability and employment conditions.

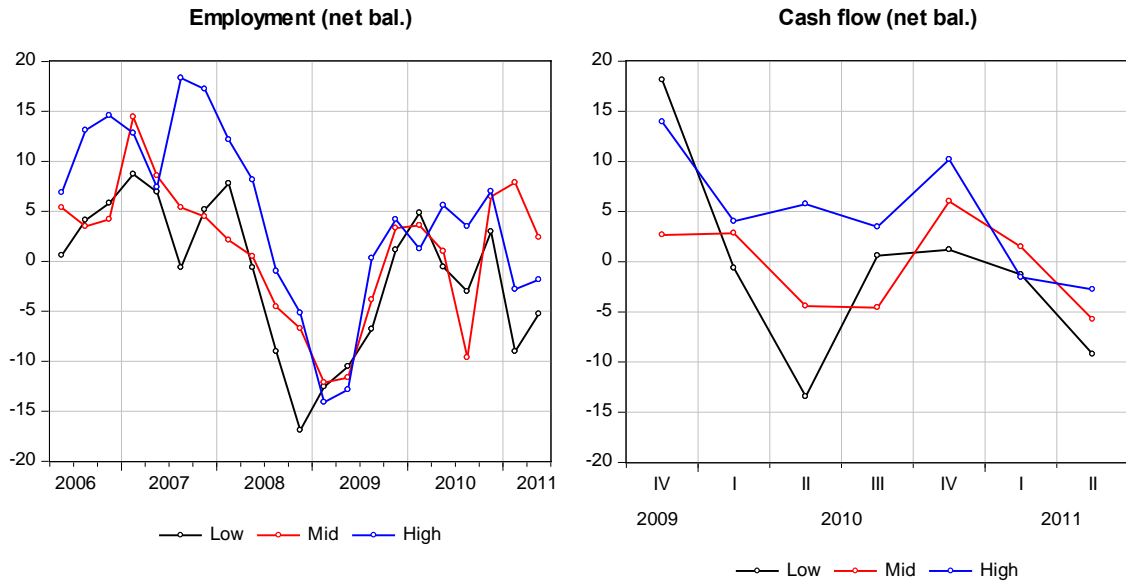
Trading conditions and profitability more closely aligned across firm size



Trading conditions and profitability of low- and high-tier firms have moved broadly together over the first half of 2011. Trading conditions for these firms were unchanged in the June quarter and remained fairly subdued, and while mid-tier firms reported a decline, their trading conditions were the best by size. Profitability improved for low- and high-tier firms, though remained weak, while mid-tier firms reported a deterioration in profitability.

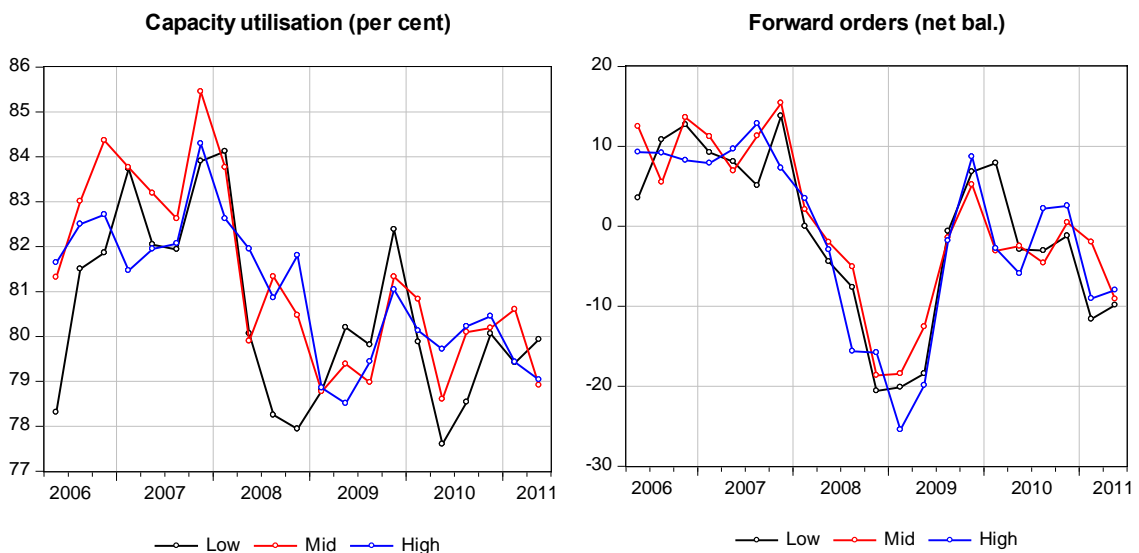
Firm size analysis (cont.)

Employment conditions less disperse across firm sizes; cash flows deteriorate across all SMEs



Employment conditions were less varied across SMEs in the June quarter than in the previous quarter. Low-tier firms reported a solid improvement in employment, while employment conditions were a little stronger in high-tier firms. In contrast, mid-tier firms' employment conditions declined, although remained strongest overall. Cash flows deteriorated across all SMEs, with cash flows now weakest for low-tier firms and strongest for high-tier firms.

Capacity utilisation falls across mid- and high-tier firms; forward orders deteriorate for mid-tier firms



Capacity utilisation was lower for mid- and high-tier firms, and it rose for low-tier firms, where capacity utilisation was the highest. Forward orders fell sharply for mid-tier firms and improved a little for low- and high-tier firms. Orders were weak and poor for all SMEs in the quarter, which is consistent with poor near-term demand.

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