

Businesses build resilience to ride the slowdown

Welcome to the first business snapshot from Westpac's Business Banking Team

Small and medium-sized enterprises (SMEs) are often called the backbone of the economy. The numbers tell the story.

In Australia, 99.8% of all businesses are small and medium-sized businesses, which is the focus of this report. They employ more than half of the Australian workforce.

That's why it's vitally important – for the health of those businesses, along with the customers and communities they serve – to understand current economic conditions and their potential impact.

Our snapshot will draw on Westpac's internal business data, as well as our own customer conversations, to deliver deep analysis on the current state of the Australian economy, economic trends, what's impacting the business sector and how customers are responding.

Our aim is not only to foster understanding for business owners and managers, but to offer a heads-up for the development of strategies, know-how and tactics to maximise the potential and productivity of businesses in the future.

We know Australian businesses are resilient and tough and they've been hit one after the other with different setbacks. From bushfires, the pandemic, and the ensuing lockdowns through to supply chain issues and labour shortages.

The year ahead brings its own challenges with higher operating costs and lower turnover as the cost of living goes up and consumer spending pulls back.

However, there's some very good news in the readiness of businesses to weather tougher conditions before they improve.

Uncertain pandemic years seem to have honed businesses' survival instincts – they have been paying down debt, maintaining lines of credit and keeping their sights on investing for the future. Some sectors are particularly well placed.

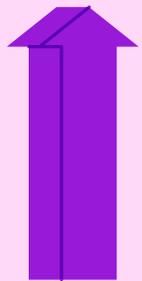
Read the report to find out more. We hope you find it helpful.





What's driving Australia's slowing economy?

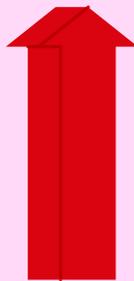
Economic indicators highlight the challenges impacting businesses



INFLATION IS HIGH

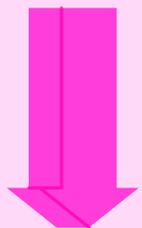
A 6% ANNUAL INCREASE IN INFLATION

Source: Australian Bureau of Statistics

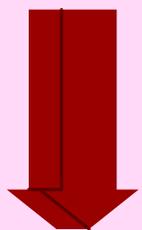


INTEREST RATES ARE UP

CASH RATE HAS INCREASED FROM 0.10% IN APRIL 2022 TO 4.10% IN JULY 2023



HOUSEHOLD DISPOSABLE INCOME IS UNDER PRESSURE, AND CONSUMER SPENDING IS SLOWING



BUSINESS SUPPORT HAS DECREASED

AROUND \$22 BILLION OF EMERGENCY BUSINESS SUPPORT IN 2022-23 WAS REPLACED WITH SMALLER AND MORE TARGETED INCENTIVES

Understanding the forces of change

Businesses across Australia are grappling with higher costs and a slowdown in consumer spending. On top of this, uncertainty around the domestic and global economies is further clouding their outlook, dampening investment and activity.

The Reserve Bank (RBA) has embarked on the most aggressive interest rate hiking cycle in modern history, taking the cash rate from 0.10% in April 2022 to 4.10% in July 2023. The lift in the cash rate has pushed up interest expenses by around 20% compared with pre-pandemic levels.

Emergency support provided by the governments during the pandemic has been phased out and replaced with smaller and more targeted incentives.

In combination, higher costs, lower turnover and greater uncertainty will add up to economic conditions that are likely to weaken further before they get better.

Chart 1: Interest paid



Index: December quarter 2019 = 100 Source: Westpac

Higher costs, lower turnover and greater uncertainty add up to economic conditions that are likely to weaken further before they get better



How do businesses shape up heading into the slowdown?

Prepared for tougher times

The business sector is financially strong as it heads into the downturn, according to Westpac internal banking data¹.

Many businesses have been preparing for tougher times by improving their liquidity position, including through paying down debts where possible, increasing their liquid assets, maintaining credit lines and investing in their productive capacity.

Businesses have bolstered their cash positions. Some are looking to invest and are waiting for the right opportunity to come, once there are more convincing signs that the cash rate has peaked. Facing into economic uncertainty and the possibility of further rate hikes, other businesses have opted to shore up their cash positions and preserved capital to help weather the storm.

Our analysis shows that businesses in the education, health, retail and wholesale industries are particularly well placed entering the slowdown.

Business balance sheets strengthened during the pandemic



OUR MEASURE OF BUSINESS LIQUIDITY IS 30% HIGHER THAN BEFORE THE PANDEMIC

Westpac's measure of liquidity, comparing business liquidity to possible calls on funds, puts the sector comfortably above pre-pandemic levels.



DEPENDING ON THE INDUSTRY, INPUT COSTS INCREASED BY AS MUCH AS 30% SINCE THE 2019 DECEMBER QUARTER



BUSINESS DEPOSITS HAVE GROWN BY AROUND 15% OVER THE SAME PERIOD

One reason is larger working capital needs due to higher costs. But a large part reflects the business sector's outright strength.

Chart 2: Business net liquidity position



Index: December quarter 2019 = 100 Source: Westpac

Chart 3: Business deposits



Index: December quarter 2019 = 100 Source: Westpac

KEY INSIGHT:

A strong cash position will be crucial for businesses as they traverse choppy waters ahead

It will also help businesses take full advantage of opportunities for expansion and acquisition of assets that are likely to arise during this economic cycle.

Our measure of liquidity is particularly strong for the retail and wholesale sectors, and education, health and other social services industries.



Trends show business lending moving towards future investment

New trends emerging in the composition of financing

Another indicator of strength is coming through new trends in the composition of financing, with many businesses looking to borrow for investment rather than operational needs.

Debt is an important source of funding for all businesses, but not all debt is created equal. When businesses have strong cash flows and are operating sustainably, the need for working capital financing and overdraft funding declines. This frees up borrowing capacity to re-invest in growing productive capacity, such as new machinery and equipment, expanding to a new premise or enhancing alternative sales channels (e.g. online solutions).

Westpac has recently seen an uptick in longer-term borrowing and working capital loans have become less important in the funding mix. This is a strong signal that businesses have been borrowing to invest, rather than to operate.

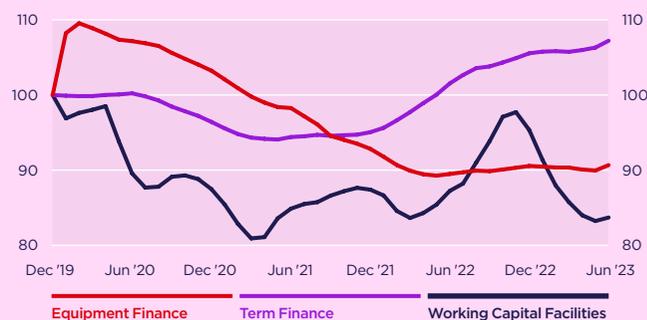
Businesses have left themselves room to flex with existing lending facilities

RBA rate hikes have contributed to a tightening in credit conditions. However, not all businesses draw down on their approved lending facilities in full. This can leave room to draw on existing lines of credit quickly if conditions change abruptly.

The share of approved lending that businesses are using – known as lending utilisation – is lower than pre-pandemic levels. This means that businesses now have a relatively large stock of funding at their disposal, which may be drawn upon as economic conditions fluctuate.

When looking at working capital facilities, including overdrafts, the share of lending businesses are using is around its lowest level since 2018. This shows that businesses are in a strong working capital position, and also have scope to draw down on existing lending facilities, if necessary. This is particularly true of health, education and other social services industries.

Chart 4: Business financing type



Index: December quarter 2019 = 100 Source: Westpac

Chart 5: Business lending utilisation by type



Index: December quarter 2020 = 100 Source: Westpac

KEY INSIGHT:

Credit lines allow businesses to be nimble when conditions change

Businesses showcased this strength in the June quarter, drawing on existing and new credit lines, alongside the strength of their balance sheets, to make the most of expiring tax incentives.

In this case, the flexibility businesses have built into their funding mix was used to capitalise on opportunities. But this agility will play an even more crucial role as conditions soften, providing businesses with the ability to respond quickly to changes in the economic environment.

2024 and beyond: What to expect?

Optimistic businesses are looking past the challenges to better times ahead

The incoming economic data clearly show that business conditions have become more challenging.

The impacts of inflation and rising interest rates are curbing consumer spending. We expect this to continue over the next year or so, before an upturn materialises.

Our report shows the business sector is entering this downturn from a position of financial strength.

The trends outlined in this report suggest many of today's businesses are in a good starting position to be part of the brighter story when the cycle moves on

Indications are that many businesses substantially have been able to absorb the higher interest rates and rising expenses – many are in a strong net liquidity position, with cash at hand and lines of credit at the ready.

Significant headroom in financing arrangements means they are nimble and able to move fast should conditions suddenly change. And, they have an eye out for a turn in the prevailing challenging conditions.

Optimistically, we're seeing many of our customers looking ahead and setting their sights on the future, as they watch out for new business and, importantly, productivity-enhancing opportunities.

Many businesses are entering the downturn from a position of strength. This robust starting point will give businesses the ability to better navigate the choppy water ahead, and provide them with the best opportunity to be a part of the brighter story when the cycle turns and the good times roll again. Since they are the backbone of the economy, that's great news for all.

Note: In this report businesses include all types of entities with annual turnover of \$50 million or less that are clients of the Westpac Group.



About the report

The new Westpac Business Snapshot report uses aggregated and de-identified data from around half a million Westpac small to medium-sized business customers. This data provides a real-time read on aggregate business conditions and the economic trends impacting the SME sector, providing our clients with insights to help them grow and prosper.

We're here to help.

 westpac.com.au/business-banking

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