QUARTERLY BUSINESS SNAPSHOT

Business backdrop brightening

30 April 2024

Businesses move past turning point

Welcome to the latest quarterly business snapshot

The quarterly business snapshot uses the Group's proprietary data to provide you with a timely pulse 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 data reveals that while Australian businesses are still facing challenges, a broad-based gradual improvement in business cash flow conditions looks to be gaining traction. This suggests that while there remains a difficult and uncertain road ahead, the worst may be behind us.

Remnants from the pandemic in the form of supply bottlenecks, labour shortages and cost pressures are still proving a complication for Australian businesses despite significant improvements. The slowdown in aggregate demand has added another dimension, weakening the ability of businesses to pass on cost pressures into their own prices.

However, since the middle of 2023 falling expense outflows have outpaced slowing income flows. This means that cash flow conditions, measured by the income to expense ratio, have staged a gentle, but nonetheless encouraging, recovery.

The improvement in aggregate cash flows has coincided with a stabilisation in business credit growth at a solid level.

As would be expected, no two industries are the same and smaller businesses are feeling the pressure more than larger Commercial business. But these smaller enterprises are using their strong balance sheets as a back stop to help them navigate the rocky terrain.

Looking ahead, the consumer side of the economy is expected to start to heal throughout the second half of this year. Pressure on household incomes peaked in 2023 and stage 3 tax cuts from 1 July will further support the recovery in household budgets. More progress on inflation and the prospect of possible rate cuts from the Reserve Bank (RBA) late in the year could also help support consumers.

Taken together with the tentative improvement in business cash flow conditions, there are signs that businesses may have passed the nadir and that a recovery will gain further traction throughout 2024.

Cash flow insights: Cost control improvements

Cash flow conditions on the rise

Business income and expense cash flows both declined in the March quarter, continuing the trend underway since the middle of 2023. However, the fall in expenses continued to outpace the slowdown in income flows, driving an improvement in the income to expense ratio.

Both income and expenses have declined for three straight quarters, but just like in the December quarter, expenses have fallen at a faster rate than incomes as inflation cools, businesses optimise costs and weaker demand means firms are purchasing fewer inputs.

3-month change:

-1.4% Income

-1.8% Expenses

0.4% Income-to-expense ratio

While still below pre-pandemic levels the income to expense ratio rose to its highest level since the December quarter of 2021.

In the last 12 months, business cash inflows have slipped 2.6% compared to a 4.2% fall in expense outflows over the same period.

This means that while cash flow conditions are still tighter than before the pandemic, the the worst may be behind us.

There is no indication that the recovery will accelerate materially from here and it is still likely to be a bumpy ride, but our customer data suggest that, in aggregate, things are heading in the right direction for businesses.

Chart 1: Business Cash Flow
Rolling 3-month Sum, Index March 2020 = 100

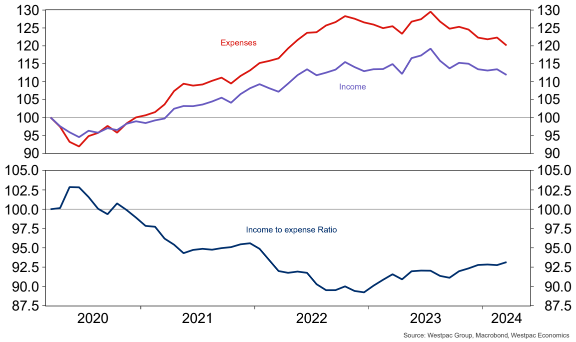
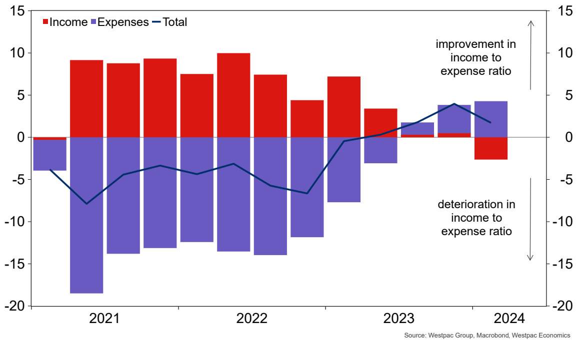


Chart 2: Income to Expense Ratio
Excluding Debt Servicing Payments, Contribution to Annual % Change



A lift in debt repayments

The improvement in the income to expense ratio over the past three quarters has been partially offset by an increase in cash payments towards servicing debt.

Payments on debt have increased by 13.3% over the year to the March quarter driven predominantly by larger Commercial businesses where credit growth has been strongest and debt levels are generally higher.

This increase in cash flows towards debt repayments likely reflects higher interest rates and solid credit growth over the period. Higher credit outstanding means businesses need to pay both more interest and more principal. Net of (rising) debt servicing payments, the recent recovery in the income to expense ratio has been a little more modest.

Debt servicing costs in aggregate are still below pre-pandemic levels, even when accounting for the recent uptick. The strong recapitalisation of business balance sheets that took place during the pandemic is still providing a tailwind to businesses.

Balance sheet insights: Aggregate balance sheets yet to budge

Smaller businesses feel the pinch

There is a growing divergence between the cash flow conditions of our SME and Commercial customers. Both cohorts of businesses are benefitting from a decline in expense outflows.

However, SMEs have experienced a much sharper slowdown in income flows. In the March quarter, SME cash inflows fell below pre-pandemic levels for the first time since lockdowns.

Divergent cash flow outcomes between businesses of different sizes are contributing to changes in business balance sheets as smaller firms lean into their savings buffers to help smooth the ride.

In aggregate, our measure of business liquidity remained steady in the March quarter at around 30% above pre-pandemic levels. But the underlying strength behind this number is highlighted by looking at the distribution of individual businesses.

Around 40% of all businesses have a liquidity ratio that's at least twice a strong as before the pandemic.

Continuing balance sheet strength is not just a legacy of the pandemic but is being supported by ongoing management of business cash stockpiles. Around 55% of businesses have deposit levels 25% larger than before the pandemic.

The drawdown of cash buffers among SMEs has left their cash levels below pre-pandemic levels, while Commercial businesses have maintained their extraordinarily strong cash buffers.

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

Chart 3: Business Liquidity Ratio by Size
Stock of Savings Relative to Debt, Index Dec 2019 = 100

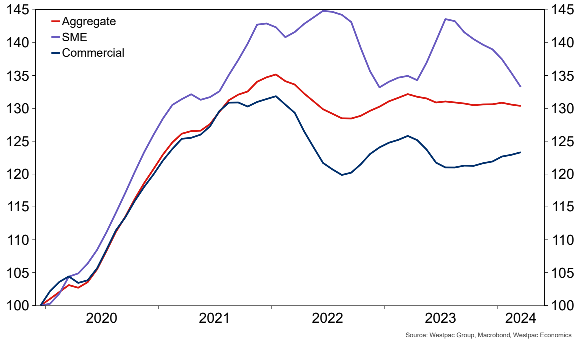
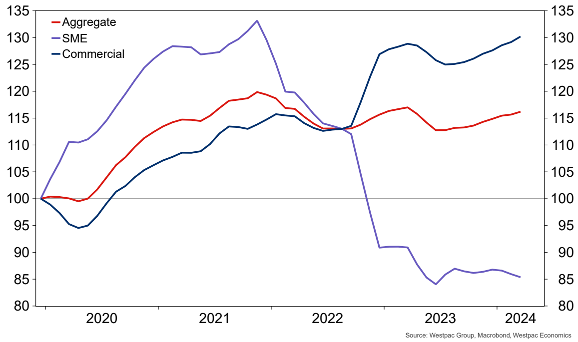


Chart 4: Business Cash Savings by Size
Rolling 3-month Sum, Index Dec 2019 = 100



Commercial businesses leaning into long-term debt

Our liquidity measure is still stronger for SMEs compared to their Commercial peers. However, the gap has recently closed. For SMEs, our liquidity measure has declined since the middle of last year, while the equivalent measure for Commercial businesses has tracked sideways.

There are two forces at play here. SMEs are drawing on their cash stockpiles to manage more challenging cash flow conditions. Commercial cash deposits are still slowly growing. Meanwhile, credit growth has been significantly stronger for Commercial businesses relative to their SME peers.

Reflecting the contrasting mindset between SME and Commercial businesses, term and equipment finance loans have increased substantially for Commercial customers, while use of working capital facilities has remained low.

SMEs have not had the same confidence to take on longer term debt to invest and grow.

Industry insights: Recovery broad-based across sectors

Overview of industry income to expense ratios

Incomes slipped in 10 of 14 industries in the March quarter. This compares to 12 industries in the December quarter. Weakness was centred on industries at the coal face of the consumer slowdown. This includes accommodation, cafés & restaurants and recreation services.

At the other end of the spectrum, personal services and property & property services sectors recorded an increase in cash inflows. The jump in personal services demand coincided with the resumption of the tertiary education semester, which likely saw an uptick in international student arrivals. The upswing in the residential property market may be supporting incomes for the property sector.

Over the past 12 months cash inflows were lower in all but two industries – education and personal services. 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 have actually increased in education, agriculture and property & property services in both quarterly and annual terms.

The income to expense ratio was mixed across industries in the March quarter. Six of 14 industries saw an improvement in the quarter, spearheaded by personal and communication services. Education and property & property services bookended the laggards as weaker income flows and higher expenses weighed.

In the year to the March quarter, the income to expense ratio rose in 9 of 14 industries, mirroring the rebound in aggregate cash flow conditions since the middle of last year. However, no industry has an income to expense ratio above pre-pandemic levels, a sign that significant challenges remain for Australian businesses.

Chart 5: Income to Expense Ratio

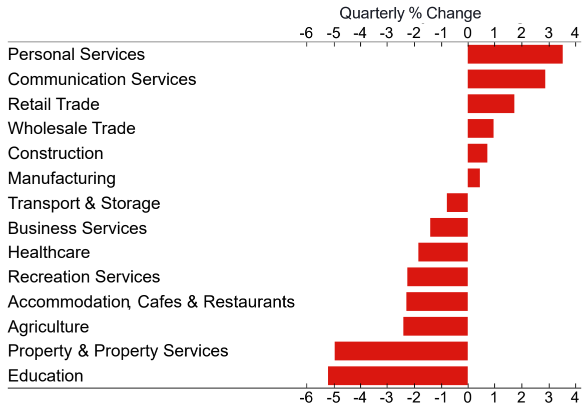
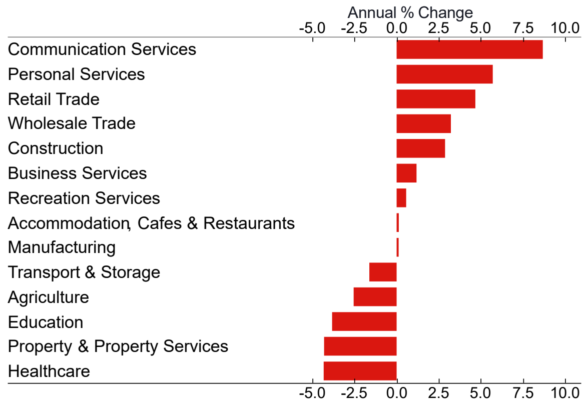


Chart 6: Income to Expense Ratio



Source: Westpac Group, Macrobond, Westpac Economics

Skipping out on the essentials

Healthcare and education generally outperform when faced with broader macroeconomic challenges due to their essential nature. They also benefit strongly from a growing population.

This outperformance was clear in our banking data through much of 2023. However, in the March quarter there were signs that these sectors are not fully immune to the broader macroeconomic pressures. Income flows slowed in the March quarter and these two industries saw less support from easing cost pressures. This was particularly the case for education, where expenses rose in the quarter. The data suggests that demand may be waning in these sectors, even with the benefit of strong population growth.

The deterioration in cash flow conditions for these essential industries may be a sign that households are starting to pull back on some essential spending to help offset cost of living pressures. There is likely a floor to the downside as there is a limit to how much households can pull back on essentials.

A look across the country: Most states join cash flow improvement

A fall in expenses economy-wide

Income flows were weaker across every major region apart from WA in the March quarter. SA/NT (-4.7%) experienced the sharpest quarterly slide, followed by VIC/TAS (-1.8%), NSW/ACT (-1.7%) and QLD (-0.7%). Cash inflows in WA rose 2.2% in the quarter, ending a string of two consecutive quarterly falls.

The fall in expenses experienced economy-wide was echoed across the country in the March quarter, although some jurisdictions experienced a sharper decline than others. At one end of the spectrum, businesses in VIC and TAS saw their cash outflows drop by 3.1% compared to a fall of just 0.2% in QLD.

The improvement in expenses outstripped slower income flows in WA and VIC/TAS, driving an improvement in cash flow (as measured by the income to expense ratio) in these regions. Cash flow conditions were broadly unchanged in NSW/ACT while cash inflows slowed more quickly than outflows in SA/NT and in QLD.

Zooming out over the past 12 months, WA has seen the strongest improvement in cash flow conditions. In fact, every major region apart from SA/NT recorded an improvement in the income to expense ratio over the past 12 months. Importantly, the deterioration in the income to expense ratio in SA/NT needs to be considered in the context of a generally more resilient starting point. Even after accounting for the recent deterioration in cash flow conditions in SA/NT, the region is still performing the second best relative to pre-pandemic levels, bettered only by WA.

Chart 7: Income to Expense Ratio by State
Excluding Debt Servicing Payments, March 2024, Quarterly % Change

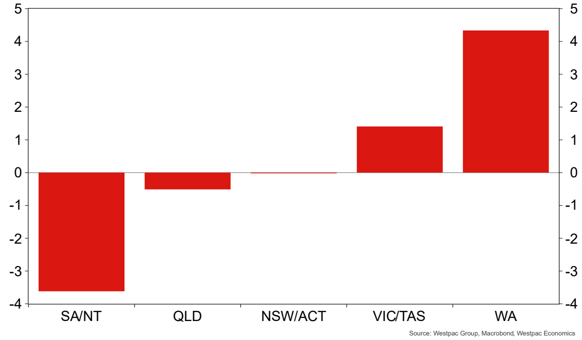


Chart 9: Business Income by State
Rolling 3-month Sum, Index March 2020 = 100

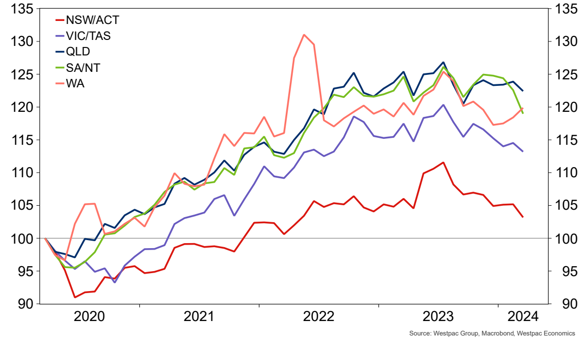


Chart 8: Income to Expense Ratio by State
Excluding Debt Servicing Payments, March 2024, Annual % Change

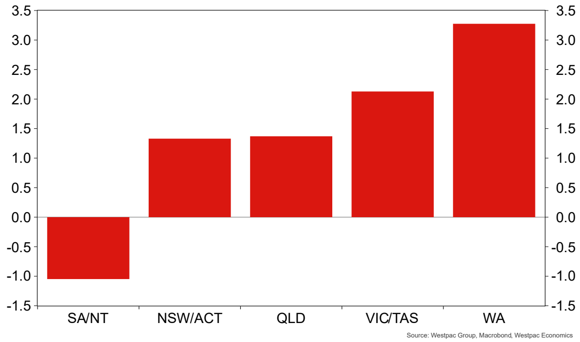
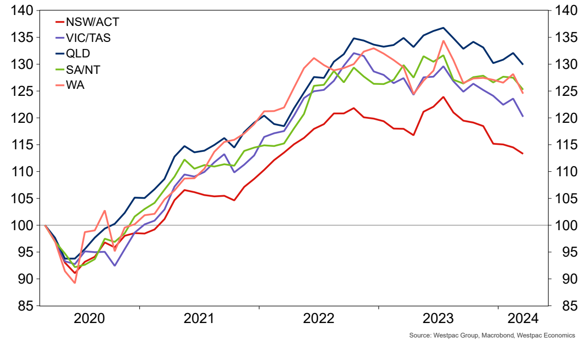


Chart 10: Business Expenses by State
Rolling 3-month Sum, Index March 2020 = 100



From encouraging signs to gradual recovery

Early signs of optimism are Building

The evidence from our business banking data has gradually evolved from businesses weathering the storm, to emerging signs that the storm is passing and that blue skies are emerging. There is always a risk that we are just in the eye of the storm and that we can expect further challenges ahead.

However, the encouraging trends in our business data and our expectation that some of the biggest macroeconomic headwinds will continue to subside over the course of 2024, gives us some quiet confidence that businesses can slowly start to unbatten the hatches.

Indeed, this already appears to be the attitude taken by many larger Commercial businesses who have seen the recent improvement in cash flow as a signal to borrow and invest in growth and productivity. As the recovery gains momentum this optimism is likely to trickle down to smaller firms, driving another leg of the expansion.

Crucially, we expect any recovery to be gradual. There remain countless headwinds to Australian businesses, global uncertainty is rife and many business surveys continue to point to caution in the face of these uncertainties. But for businesses, cash is king, and our transactional data provides some good reason for optimism.

There are also several structural forces that stand to support well-placed and adaptable businesses. As the post-pandemic turblance clears, businesses are freeing up the bandwidth to refocus and reinvest in productivity improvements and innovation. This includes through decarbonisation and the adoption of new technologies such as aritifcial intelligence.

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.

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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