BUSINESS SNAPSHOT

Businesses eyeing a brighter year ahead

9 February 2024

Business sector stable despite a softening economy

WELCOME TO THE LATEST QUARTERLY BUSINESS SNAPSHOT.

The quarterly business snapshot utilises the Group's proprietary data to provide you with a timely pulse on Australian businesses[1]. Our report analyses the millions of daily transactions made by our business banking clients, unlocking a rich source of data on businesses nationwide.

Australia's economy is in transition. After a period of turbulence following the pandemic, conditions are slowing, as supply and demand move into better balance. Higher interest rates are taking effect. As a result, the economy is slowing and inflation is falling back towards the Reserve Bank's (RBA) 2–3% target after reaching levels not seen in over three decades.

The latest edition of our quarterly business snapshot shows that, despite growing challenges, the business sector remains resilient and is open-minded about the year to come.

Business activity is slowing as the economy cools. Our latest data shows that the slowdown continued in the December quarter. However, that's not the most important part of the story. Cost pressures are also easing as the global inflation pulse subsides and businesses adapt to minimise costs. That decline has more than offset the slowdown in sales over the December quarter. This means total business cash flow remained stable. Despite this, some businesses continue to point to cash flow as a binding constraint on future expansion.

Reflecting this solid foundation, businesses remain cautiously optimistic. They expect that the worst is behind us when it comes to cost pressures, and that turnover will stabilise before growing as we move further into 2024.

Still strong financial buffers are providing businesses with good reason to be optimistic. We have previously highlighted that businesses accumulated large cash buffers and have paid down debt where possible. In aggregate, businesses have not yet had to lean on these buffers – they still have a safety net to face any unforeseen shocks, and the firepower to invest in their capacity and new technologies such as AI, building a digital presence and the transition to net-zero.

1. See definition on page 9.

Turnover insights: Slowdown continued but moderated

WEAKER DEMAND AND SLOWER INFLATION TO BLAME

Our business banking data shows that business turnover declined again in the December quarter, falling around 3%. This was a smaller decrease than in the previous quarter and may suggest that spending over the festive season supported sales.

A large part of the fall in turnover is being driven by a slowing economy. Household incomes are coming under severe pressure from the combined impacts of high inflation, a rising tax take, and higher interest rates.

In response, households are pulling back on their spending and saving less. Some households are relying on savings buffers to supplement their income. Businesses are beginning to see this change in behaviour reflected in their own sales, particularly in industries that provide discretionary goods and services.

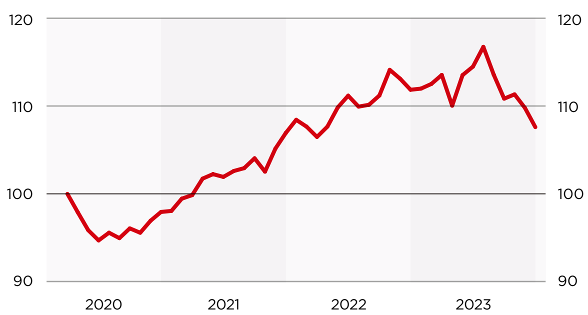
Our transactional banking data captures the total value of customer transactions. This means our measure of turnover is also slowing because inflation is moderating. As we will explain, this is good news for businesses.

Indeed, business leaders are still optimistic that turnover will improve in the year ahead. A recent survey[2] of Australian business leaders suggests that 66% of leaders expect their business' sales to increase within the next 12 months. However, reflecting the evolving economic conditions, this figure has been steadily declining since October 2021.

Business turnover declined in 12 of 14 industries over the December quarter, unchanged from the September quarter. Essential industries that are benefitting from a rapidly growing population, including healthcare and education, continue to perform relatively better.

2. The survey was commissioned by the Group and conducted by Lonergan Research. Further information on the scope of the survey can be found on page 9.

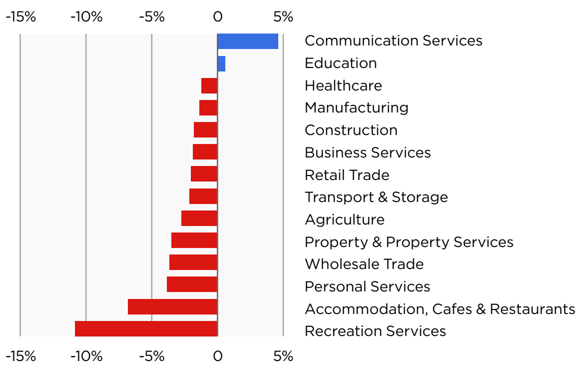
Chart 1: Business income



Index: March quarter 2020 = 100 **Source:** Westpac Group

Chart 2: Business income

Change over the December quarter 2023, by industry



Source: Westpac Group

KEY INSIGHT: HOSPITALITY SPENDING STILL HIGH, BUT NORMALISING

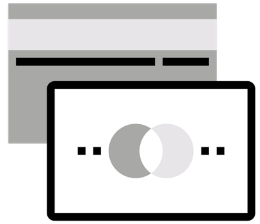
When budgets are stretched, the first place households look to cut back is discretionary spending.

It is for this reason that slowing demand tends to show up first, and be more acute, in these discretionary categories.

Despite the festive boost, this theme rang true in the December quarter. The retail, recreation services, and accommodation, cafés & restaurants industries were among the weakest in the quarter.

Resilience in spending on dining out was a surprising theme throughout most of 2023, even as prices jumped sharply and budgets were stretched. However, this started to reverse quickly in the December quarter.

Importantly, the level of spending on accommodation, cafés & restaurants is still high, at more than 20% above pre-pandemic levels. This suggests that some of the recent weakening in this category is a 'normalisation' in spending patterns after a period of strong growth.



Expense insights: Costs critical for businesses

COSTS CONTINUE TO SUBSIDE FOLLOWING THE INFLATION PEAK

In 2023, cost pressures stabilised and inflation began to subside from its peak at the end of 2022. Encouragingly, our business banking data shows that this process looks to have continued in the December quarter and the pace of decline accelerated.

This reflects several factors, including improved supply chains and easing costs for producing and shipping goods. Labour market pressures have also eased a little, helping to take some of the heat out of labour costs.

In the December quarter, business expenses declined by around 4%, to their lowest level since the March quarter 2022. Declines were broad-based across industries. In fact, 13 of 14 industries recorded declines in expenses in the quarter.

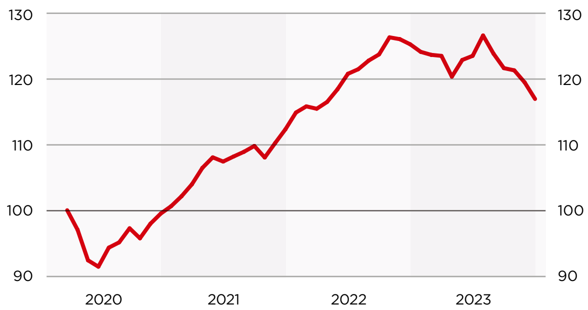
An important component of this fall in expenses was the wages bill, which declined by around 1% in the quarter. Businesses are requiring fewer hours from their employees as demand slows and a gradually easing labour market is reducing wages pressures. Supporting this, Australian Bureau of Statistics (ABS) Labour Force data showed that hours worked declined by 0.4% in the December quarter.

13 of 14 industries recorded declines in expenses in the December quarter.

As inflation continues to ease, businesses costs are expected to slow further.

Another important component of the fall in expenses in the December quarter was slower price increases for non-labour inputs. ABS data shows that producer prices rose 0.9% in the December quarter, compared to 1.8% in the September quarter.

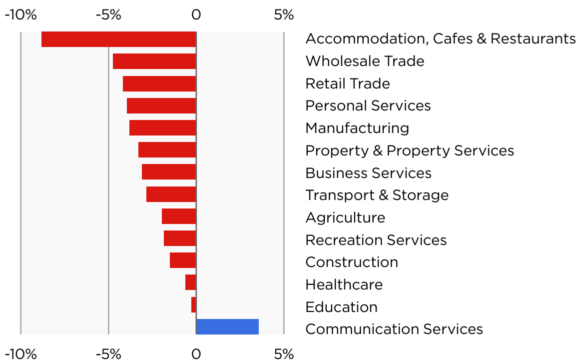
Chart 3: Business expenses



Index: March quarter 2020 = 100 **Source:** Westpac Group

Chart 4: Business expenses

Change over the December quarter 2023, by industry



Source: Westpac Group

KEY INSIGHT: DISCRETIONARY INDUSTRIES SAW COSTS EASE THE MOST

Discretionary industries reduced their expenses in the December quarter as cost pressures eased and businesses adjusted to weaker demand from consumers.

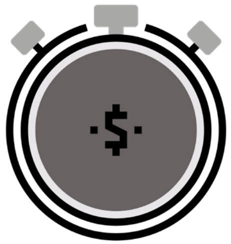
Accommodation, cafés & restaurants recorded the largest decline, with expenses dropping almost 9% in the quarter – the most of the 14 industries monitored.

The total wage bill – a key input cost – declined by over 3%. A sizeable part of the decline reflected an adjustment to weaker trading conditions as the cost of goods sold also eased.

Wholesale and retail trade, and personal services also recorded large declines in expenses of around 4–5%.

At the other end of the spectrum, activity in the healthcare and education industries is running relatively strong, supported by the growing population. Consequently, costs in these industries remained comparatively high in the December quarter.

Income and expenses: Business cash flow steady



OPPOSING FORCES ARE BROADLY OFFSETTING

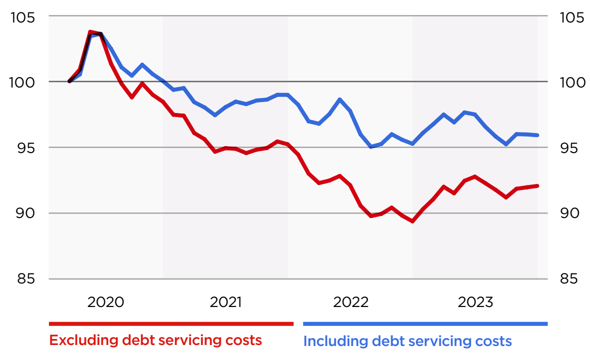
Cash flow is always top of mind for businesses, and can often be an obstacle to expansion, investment, or even day-to-day operations. Understanding the forces driving changes in cash flow is therefore crucially important. As the economy slows, turnover and expenses are moving in the same direction. But it is the balance of these two crosscurrents that matters for business cash flow. If expenses fall more than turnover businesses will be more profitable, and vice versa.

The slowdown in spending continued in the December quarter. However, expenses declined even further, which more than offset the soft turnover. As a result, the income to expense ratio increased slightly, which can be interpreted as an improvement in business cash flow in the quarter. Over 2023 as a whole, this measure improved. This speaks to businesses' ability to adapt in the face of the slowdown in economic activity throughout the year.

Our data also highlights how business decisions are helping bolster resilience. In addition to realising cost efficiencies, businesses have paid down debt where possible, helping to offset the increase in debt servicing costs from higher interest rates. Including debt servicing costs in the expense measure, the income-to-expense ratio has been more resilient relative to pre-pandemic levels. Measures including debt servicing costs also stabilised earlier than measures of cash flow which exclude these costs.

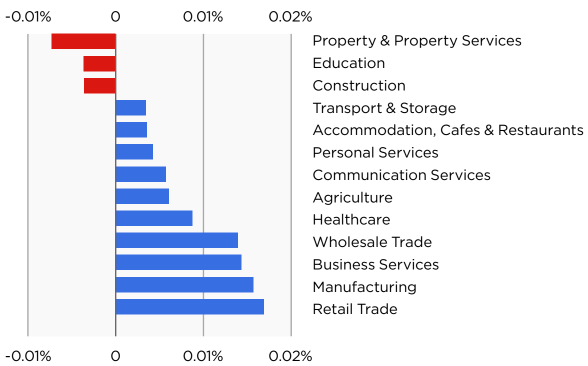
Looking at this broader measure of business cash flow (including debt servicing costs), we saw improvements across most industries, with retail and wholesale trade, manufacturing, and business services outperforming. Property services, education and construction experienced a deterioration in cash flow.

Chart 5: Business income to expense ratio



Index: March quarter 2020 = 100 **Source:** Westpac Group

Chart 6: Business income to expense ratio, including debt servicing costs
Change over the December quarter 2023, by industry



Source: Westpac Group

BUFFERS PAYING DIVIDENDS

Our first quarterly business snapshot highlighted the stark improvement in aggregate business balance sheets among our business bank clients during the pandemic. Many businesses stockpiled cash and paid down debt, putting them in a significantly stronger position than before the pandemic.

Due to the large amount of debt previously repaid, and the liquidity buffers built up, total debt servicing costs for our business bank customers remain below their pre-pandemic levels on average. This is despite some recent increases. This is impressive given the RBA has increased the cash rate by 425 basis points over almost two years.

Stronger balance sheets mean businesses have a cushion against a decline in revenue. This is likely preventing a deeper slide in confidence that might be expected given the economic backdrop. Encouragingly, our measure of liquidity remains high, having drifted sideways over recent quarters.

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

SME vs Commercial: Does size matter?

A TALE OF TWO EXPERIENCES

Looking across businesses of different sizes, our business banking data shows that **SME** and **commercial** businesses experienced a similar dynamic over the December quarter. Turnover slowed, but further relief on costs offset this and left cash flow broadly steady for both groups. But stepping further back, these two business groups are facing different challenges.

Due to several factors, including pricing power, scale and industry, SMEs are typically more sensitive to the economic cycle. This means they feel the impacts of slowing activity sooner, but are also more responsive to the eventual upswing. As expected, turnover declined earlier for SMEs than for commercial businesses – starting from early 2022, rather than from mid-2023 for the commercial group.

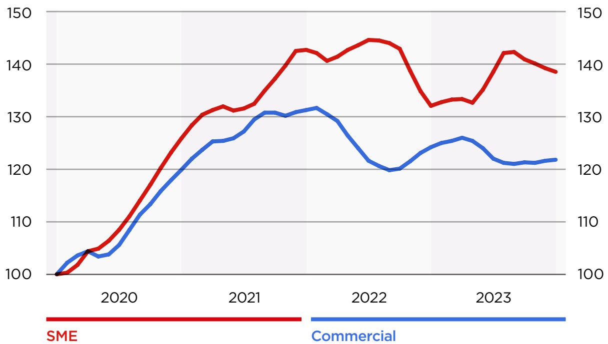
The consequence is that SME businesses saw their revenues begin to ease while costs were still on the way up, reducing cash flow. More recently, inflation and cost pressures have fallen and conditions for SMEs stabilised throughout 2023. For commercial businesses, turnover and costs slowed at the same time, largely offsetting each other, and preserving business cash flow.

BUSINESS SIZE DEFINITION:

SME businesses are those with annual aggregated turnover of less than $5m.

Commercial businesses are those with annual aggregated turnover between $5m and $50m.

Chart 7: Business liquidity by size



Index: December quarter 2019 = 100 **Source:** Westpac Group

INVEST AND GROW VS TAKING IT SLOW

Unsurprisingly, SME and commercial businesses also differ in how they are responding to the economic challenge. SMEs have relied partly on some of their financial buffers to cushion them from slowing demand, including by using more of their working capital facilities. SMEs have also used their cash buffers to continue paying down longer-term debt, improving their overall financial position.

Despite experiencing an earlier slowdown in activity, our liquidity measure is higher relative to pre-pandemic levels for SMEs than for commercial businesses. SMEs are battening down the hatches and adapting to tougher conditions. Reflecting this, a recent survey[3] of business leaders found that 43% of businesses with fewer than 20 employees were aiming to maintain business 'as is' over the next 12 months, rather than looking to grow or expand.

Commercial businesses are taking a different approach. Having experienced a less significant slide in conditions, they have not needed to draw on their financial buffers. This is giving them confidence to focus on growth and investment. A whopping 92% of business leades employing between 20 and 200 workers are looking to invest over the next year. This ambition to grow and invest has been evident among the Group's commercial business customers in recent quarters, manifesting as an increase in both long-term borrowing and equipment financing.

SMEs are battening down the hatches and adapting to tougher conditions, while commercial businesses are looking to grow and invest.

3. The survey was commissioned by the Group and conducted by Lonergan Research. Further information on the scope of the survey can be found on page 9.

Businesses ready to bring on the new year

2024 IS SET TO BE A TALE OF TWO HALVES.

Our business banking data shows that businesses have largely managed to weather the unfolding economic slowdown.

Progress on cost inflation is more than offsetting the decline in demand, meaning businesses have fared relatively well and have not yet had to draw on their strong balance sheets.

2024 will be a year of two distinct halves. As the RBA's battle with inflation continues, the economy is expected to slow further. As inflation nears the RBA's 2–3% target, there will be less of a windfall from cost pressures declining more than revenues.

Later in the year, however, businesses with customer bases in the household sector will start to see a recovery in demand.

To date, households have been squeezed by the high cost of living, a rising tax take and, for some, higher interest rates. But with inflation easing, tax cuts legislated to commence from 1 July, and the RBA likely to begin cutting rates later in the year, household spending power is likely to improve.

The resilience of businesses to date gives us confidence that the sector will continue to deflect the upcoming challenges.

While there are still some grey skies ahead, the resilience of businesses to date and the preservation of important financial buffers gives us confidence that the sector will continue to deflect the upcoming challenges.

Importantly, Australia's business leaders are thinking positively. Nearly 60% of business leaders recently surveyed[4] said they are optimistic coming into 2024. That's a healthy start.

4. The survey was commissioned by the Group and conducted by Lonergan Research. Further information on the scope of the survey can be found on page 9.

Appendix 1: Major indicators by industry, annual % change

	Expenses			Income			Debt servicing costs			Wages		
	2023	**2022**	**2021**	**2023**	**2022**	**2021**	**2023**	**2022**	**2021**	**2023**	**2022**	**2021**
Accommodation, Cafes & Restaurants	7.5	23.8	18.8	3.5	18.1	14.8	8.3	-3.4	1.7	4.5	15.5	20.9
Agriculture	-0.9	10.5	11.9	0.1	3.2	7.6	1.2	4.2	5.0	5.4	3.7	10.1
Business Services	1.9	11.3	16.5	4.5	5.8	9.0	8.8	-3.0	-7.4	3.6	11.7	15.3
Communication Services	1.1	3.0	12.4	0.8	1.1	3.8	-3.0	-25.0	-5.9	5.7	10.8	-0.3
Recreation Services	-7.0	16.5	23.5	-1.3	-0.9	9.3	-8.4	-3.8	2.2	1.8	16.9	17.6
Education	13.5	11.7	5.6	10.9	8.6	-0.2	4.0	1.5	-11.3	11.6	9.2	23.3
Healthcare	5.3	10.3	13.3	7.2	4.7	4.6	13.8	-12.8	-11.4	6.5	9.0	20.1
Manufacturing	0.9	9.6	8.0	1.8	6.4	3.7	5.3	-2.3	-12.5	3.8	6.8	11.9
Personal Services	5.7	14.3	8.8	4.4	8.1	2.5	5.9	-6.5	-21.1	1.8	10.7	19.3
Retail Trade	-2.1	12.4	8.5	-1.7	8.3	1.0	11.5	-13.4	-12.6	4.0	8.8	8.9
Transport & Storage	5.5	27.6	5.9	6.6	21.6	5.1	2.8	1.3	3.5	6.4	4.7	10.3
Wholesale Trade	-6.5	7.1	6.9	-5.1	4.9	1.6	-2.2	-8.1	-2.3	1.6	5.8	7.4
Construction	-1.8	15.6	11.9	0.9	12.3	7.4	30.5	-14.4	-2.2	10.9	5.2	7.1
Property & Property Services	-8.2	9.8	22.1	-8.1	7.1	12.6	7.5	16.7	-17.4	7.4	3.8	13.3
Total	**1.4**	**12.6**	**10.8**	**1.9**	**7.7**	**5.3**	**5.8**	**-6.8**	**-6.7**	**4.7**	**9.6**	**13.5**

About the report

The quarterly business snapshot uses aggregated and de-identified data from our business bank customers. Westpac Institutional Bank customers are not included in the scope of this report. This data provides a real-time read on aggregate business conditions and the economic trends impacting small and medium 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.

The report also draws on a survey of business leaders conducted by Lonergan Research. The survey was commissioned by the Group and conducted by Lonergan Research in accordance with the ISO 20252 standard. 502 Business Leaders each employing up to 200 staff were surveyed throughout Australia including both capital city and non-capital city areas. The survey was conducted online amongst members of a permission-based panel, between 9th October and 18th October 2023. After interviewing, data was weighted to the latest population estimates sourced from the Australian Bureau of Statistics.

We're here to help.

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