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SME PMI® Business Activity Report.

Exclusive insights into the SME economy presented by Judo Bank.

Business activity slows with a slight decline in new orders.

Key findings

Activity softens amid renewed service sector contraction

Cost pressures rose in July

Business confidence improves among SMEs

Business activity across Australian SMEs recorded another marginal decline in July, according to the latest Judo Bank SME Business Activity Report data. Lower new orders, across both the manufacturing and service sectors, underpinned the latest fall in overall output. Concurrently, spare capacity developed, which led to the lowering of employment levels. Overall optimism among SMEs nevertheless improved at the start of the second half of 2023, even as prices rose at faster rates.

The seasonally adjusted Judo Bank Australia SME Business Activity Index fell to 49.1 in July, down from 49.6 in June. Posting below the 50.0 neutral mark for a second straight month, the latest data signalled a sustained contraction in business activity within the SME sector. That said, the rate of decline remained mild.

In a reversal of fate, the latest contraction in SME business activity was concentrated in the service sector as manufacturing production rose at the start of the second half of 2023. This was attributed to a stabilisation of manufacturing demand, leading to a markedly slower contraction in new orders. On the other hand, services new business declined for the first time since March, albeit only fractionally. Higher interest rates and softening economic conditions were reported to have affected client demand. Overall new business among SMEs registered a marginal fall in July, the first in four months.

On the back of a renewed contraction in new work among SMEs, the level of outstanding business dropped at a faster rate in July. The trend between manufacturing and services again diverged, with a slowdown in the depletion of backlogged orders among goods producers contrasting with a hastening of the pace at which service providers went through their incomplete work.

With spare capacity developing at a faster rate among SMEs compared to larger enterprises, the former also saw a first fall in employment levels since December 2022. That said, the decline in workforce capacity was only slight and attributed both resignations and redundancies. At the same time, average staffing levels continued to rise across the whole of Australia.

Meanwhile input cost inflation at SMEs rose in July after falling through the prior three months. A renewed rising of cost pressures within the service sector, underpinned by higher raw material and labour costs, accounted for the latest changes. The rate at which input prices rose among SMEs also surpassed the overall level for Australia.

As a result of rising cost burdens, SMEs raised their charges at a faster rate in July. Output price inflation climbed back above the series average and indicated sharp price increases over the latest survey period.

Finally, despite slowing demand and rising costs, business confidence among SMEs improved at the start of the second half of 2023. The Future Output Index rose to the highest level since January, supported by improvements in sentiment across both the manufacturing and service sectors. Firms were generally hopeful that better economic conditions ahead can help to drive sales in the coming 12 months.

Judo Bank SME Business Conditions Index

sa, >50 = growth since previous month

Sources: Judo Bank, S&P Global PMI.
Data were collected 11-26 July 2023.

Comment

"SME business activity is holding up better than what we are seeing among large businesses where activity has weakened at a more rapid pace over the past three months."

Warren Hogan
Chief Economic Advisor at Judo Bank

Comment

"Australian SMEs experienced a small drop in activity in July which is consistent with the broader slowdown in the Australian economy in 2023."

Warren Hogan, Chief Economic Advisor at Judo Bank said:

"Australian SMEs experienced a small drop in activity in July which is consistent with the broader slowdown in the Australian economy in 2023. The output index dropped below 50 in June and fell further to 49.1 in July, which is broadly consistent with a stable business environment.

"SME business activity is holding up better than what we are seeing among large businesses where activity has weakened at a more rapid pace over the past three months.

"The survey shows that just 26% of Australian SMEs experienced a decline in activity in July, which although a little higher than the long-run average of 22%, shows that most Australian SMEs are seeing stability in their market or are continuing to grow.

"There has been some shift in expectations although the index reading on future activity, a good proxy for SME confidence, remains strongly positive at an index of 65.6, up 1 point in July to be the highest reading since January.

"The pipeline of work in the services sector is receding. The outstanding business index fell 1.3 points to 46.5, which is in contractionary territory. Just 9% of service sector SMEs have recorded an increase in outstanding business while 18% are registering declines.

"For SME manufacturers, the July data pointed to a recovery of activity with the output index jumping back above 50 for the first time in 2023. Encouragingly, the backlog of work improved as did expectations of future output, which rose to the highest level in a year to 71.5.

"Overall, the SME sector remains in good shape with only a gradual slowdown in activity evident across both the services and manufacturing sectors. Indeed, the July Judo Bank PMIs point to a better performance from SMEs through the course of the economic slowdown in 2023. This contrasts with 2022, when most of the slowing in business activity was due to weaker trading conditions in the SME sector.

"Inflation pressures intensified in July with all the major price indexes rising in the month. In the services sector, 23% of businesses put their prices up in July. This is almost double the proportion that put them up in June (12%) and well above the long-run average number of 11%. Almost three-quarters of service sector businesses kept prices the same in July which means that less than 5% saw price declines.

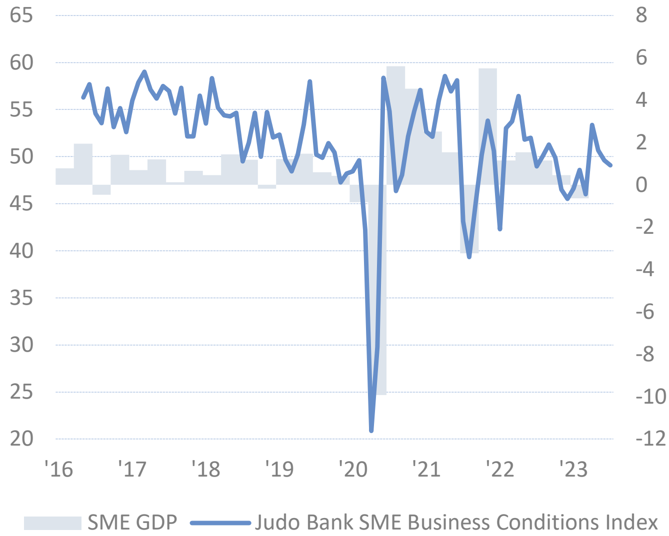
"Across the SME sector as a whole, input prices rose by 3 points in July to an index level of 63.5, showing that domestic energy and labour cost pressures are not abating. The SME final price index also rose in July. The output price index jumped 2.1 points to 55.6, a level that suggests inflation may be running somewhere between 4% and 5% over the second half of 2023.

"Our assessment of the trends in the price indexes concludes that SME margins remain under pressure in 2023. SMEs are unable to pass on all the cost pressures they are experiencing which has been the case for much of the last 2 years.

"Strong market conditions suggest that this margin compression is manageable for the time being, although a more sustained slowdown in the economy without a material easing of cost pressures could bring the viability of some businesses into question."

Judo Bank SME Business Conditions Index

sa, >50 = growth since previous month % qr/qr



Sources: Judo Bank, S&P Global PMI, Australian Bureau of Statistics via S&P Global Market Intelligence.

Judo Bank SME Business Conditions Index

sa, >50 = growth since previous month

Sources: Judo Bank, S&P Global PMI.

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Sources: Judo Bank, S&P Global PMI.

Comment

"Overall, the SME sector remains in good shape with only a gradual slowdown in activity evident across both the services and manufacturing sectors."

Warren Hogan
Chief Economic Advisor at Judo Bank

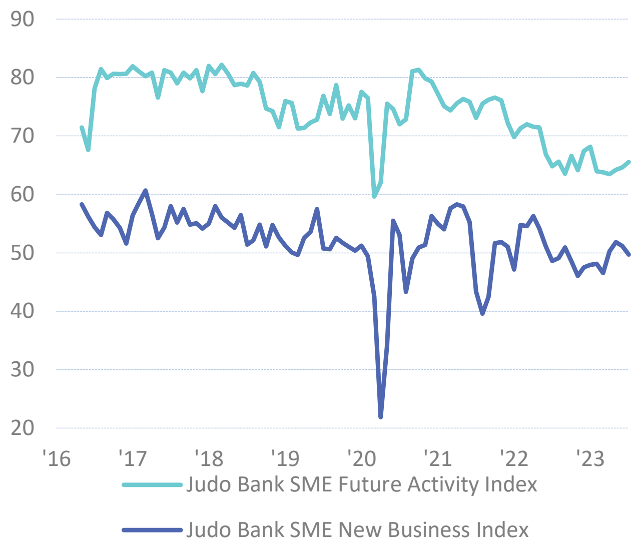
Business confidence among SMEs improved at the start of the second half of 2023.

Demand and outlook

New orders for goods and services from Australian SMEs declined in July, albeit only fractionally, following three straight months of growth. This was underpinned by a deterioration in demand conditions for services, with higher interest rates and softening economic conditions leading to a marginal decline in services new business. The manufacturing sector meanwhile saw an eighth successive monthly reduction in new orders, but at a markedly slower rate compared to June.

On the other hand, sentiment among Australian SMEs improved in July, with both manufacturing and service sector firms more optimistic about the 12-month outlook for output. Although historically subdued, Australian SMEs were the most upbeat in six months, buoyed by hopes of better economic conditions ahead. Business confidence among manufacturing SMEs rose sharply and to the highest in almost a year.

sa, >50 = growth since previous month



Sources: Judo Bank, S&P Global PMI.

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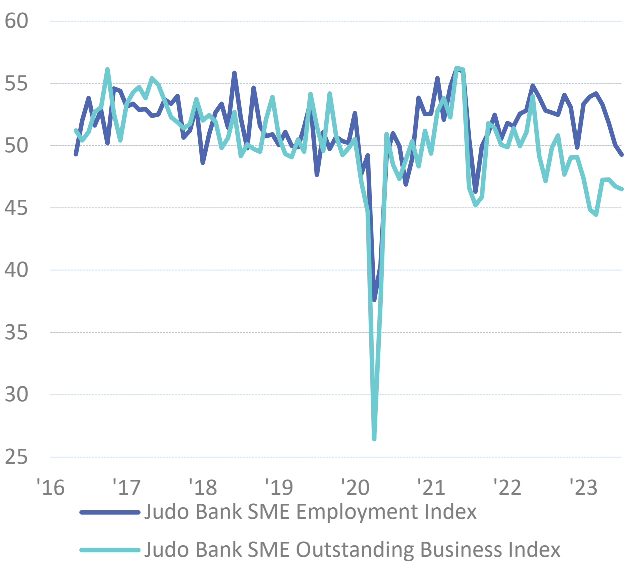
Employment and capacity

In line with demand and output, staffing levels among SMEs in Australia fell marginally over the latest survey period. This was attributed to job shedding across goods and service providers at comparable rates. Anecdotal evidence suggested that both resignations and redundancies contributed to the latest fall in employment.

Additionally, spare capacity continued to build with the latest downturn in new orders leading to a decline in the level of backlogged work for the tenth straight month. This had likewise contributed to the reduction in labour demand. Outstanding work depleted at the fastest rate in four months, owing mainly to a sharper fall among service providers. By contrast, manufacturers cleared their backlogged orders at a much slower rate than in June.

sa, >50 = growth since previous month



Sources: Judo Bank, S&P Global PMI.

Comment

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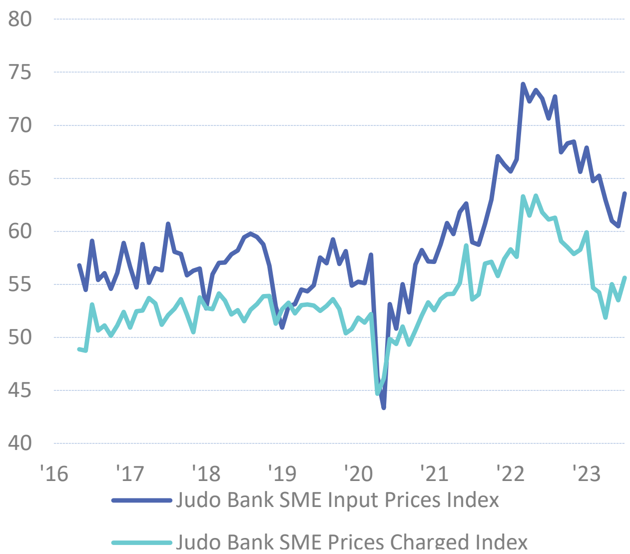
Prices

Despite a slowdown in activity among SMEs, price pressures increased with both input cost and output price inflation rates rising at the start of the third quarter. The seasonally adjusted Input Prices Index climbed to the highest since March, primarily due to a faster increase in service sector costs as manufacturing cost inflation remained unchanged from June. Higher raw material and staff costs were often mentioned by panellists.

As a result, SMEs continued to share their higher cost burdens with clients, leading to output charges rising at the fastest pace in six months. Firms in the goods producing sector notably saw renewed selling price inflation at the start of the second half of 2023, after reducing prices over June.

sa, >50 = inflation since previous month



Sources: Judo Bank, S&P Global PMI.

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Survey methodology

The Judo Bank SME Business Activity Report is compiled by S&P Global from responses to questionnaires sent to around 650 manufacturing and service sector SMEs. SMEs are defined as companies with less than 200 employees. The sectors covered include manufacturing, consumer services (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The manufacturing and services panels are stratified by detailed sector and company workforce size, based on contributions to GDP. Data collection began in May 2016.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

The headline figure is the SME Business Conditions Index, a GDP-weighted average of the SME Manufacturing Business Conditions Index and the SME Services Business Conditions Index. These are diffusion indices calculated from questions that ask for changes in the volume of output (for manufacturers) or business activity (for service providers) compared with one month previously. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

For further information on the survey methodology, please contact economics@ ihsmarkit.com.

About Judo Bank

Judo Bank is Australia's first purpose-built challenger bank for small and medium-sized businesses (SMEs) and the first fully licensed Australian bank to IPO in 25 years. Judo was founded by a small group of experienced lending professionals and its purpose is to be the most trusted SME business bank in Australia. The company's relationship-led lending model, which brings back the craft of relationship banking, is enabled by its legacy free, digital, cloud-based technology architecture. Lending products are originated and distributed through direct and third-party channels and are funded by deposits, wholesale debt and regulatory capital. www.judo.bank

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