SMEconomics.™

October 2023

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SME PMI® Business Activity Report.

Exclusive insights into the SME economy presented by Judo Bank.

Business activity declines in October

Key findings

Incoming new business marginally contracts

Confidence falls to second lowest on record

Price pressures ease for SMEs

Business activity across Australian SMEs fell at the start of the fourth quarter, according to the latest Judo Bank SME Business Activity Report data. A sharper downturn in manufacturing output was observed alongside a renewed fall in services activity. This was as overall demand conditions softened and business confidence fell to the second-lowest on record. As a result, spare capacity further developed, which led to job shedding in October, albeit only marginally. Price pressures further eased as a reflection of softening demand.

The seasonally adjusted Judo Bank Australia SME Business Activity Index slipped to 47.6 in October, down from the 50.0 neutral print in September. This signalled a renewed decline in business output at the start of the fourth quarter, though only moderately.

Central to the latest downturn in SME activity was a decline in incoming new business. This was driven by a sharp fall in new work intakes at manufacturers, while services new business near-stalled in the latest survey period. Where lower new orders were reported within the manufacturing sector, firms highlighted the softening of economic conditions weighing on goods demand. Notably, despite October's downturn marking the fourth consecutive fall in new business among SMEs, the rate of contraction was only marginal and far slower than that among large enterprises.

As a result of the reduction in new work, the volume of backlogged work continued to deplete across Australian SMEs. This was more pronounced for goods producers than service providers.

The heightened development of spare capacity within the SME sector led to firms lowering employment levels in October. This was only the fourth time that job shedding occurred within the Australian SME sector in the past three years. The fall in headcounts was concentrated within the manufacturing sector as services firms kept staffing levels unchanged in October.

On prices, average input prices continued to rise in October amidst higher wages, raw material prices and fuel costs. That said, the rate of cost inflation was the lowest in four months and only slightly above the series average. This was in contrast to the rising inflationary trend among large enterprises.

In turn, Australian SMEs were able to pass on rising costs at a slower rate to clients, leading to a third monthly fall in the rate of selling price inflation. In line with the trends for the whole of Australia, price pressures were more pronounced within the service sector rather than in manufacturing.

Finally, overall sentiment within the Australian SME sector remained positive at the start of the final quarter of 2023. That said, the level of business confidence was the second-lowest (behind March 2020) since data collection began in May 2016. Heightened concerns over the economic outlook dampened optimism according to panellists.

Judo Bank SME Business Conditions Index

sa, >50 = growth since previous month

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

Comment

"The SME economy remains in good shape in October despite slower activity and margin pressures."

Warren Hogan
Chief Economic Advisor at Judo Bank

Comment

"While slowing, SME activity continues to be on track for a soft landing, particularly in the services sector."

Matthew De Pasquale, Economist at Judo Bank said:

"SME business conditions softened in October after an improvement the month prior. SMEs and larger organisations are experiencing similar conditions as the economy weakens, with margin pressures becoming more alike through October.

"After reaching the neutral level in September, the SME Output Index has softened to 47.6, a level historically consistent with a mild economic slowdown. The Output index for larger organisations also fell to 47.6, despite seeing a more significant increase into expansion territory over the month prior.

"Similarly, new orders softened for SMEs through October, but to a lesser degree than larger organisations. The New Orders index eased only to 49.5, slightly under the neutral level, reflecting the strength in services consumer demand witnessed in official economic data releases. Larger organisations, on the other hand, saw one of the steepest declines in new orders on record, with the index falling from 54.1 to 45.0.

"The cooling economy has seen a slowdown in SMEs expanding their labour forces, but we are not seeing signs of labour shedding, with the index still floating around the neutral level at 49.9. The resilience of this indicator speaks to the elevated level of consumer demand, particularly in the services sector, which remains solid despite higher interest rates slowing the economy.

"In October, both input and output prices experienced a decrease in pressure, although margin pressure still persists. The output price index has returned to pre-pandemic levels, standing at 52.8. However, the input price index remains almost 10% above pre-pandemic levels, currently at 60.9. SMEs have been under more significant margin pressure than larger organisations throughout 2023, but in October, the pressure on larger organisations increased, bringing it in line with the pressure faced by SMEs.

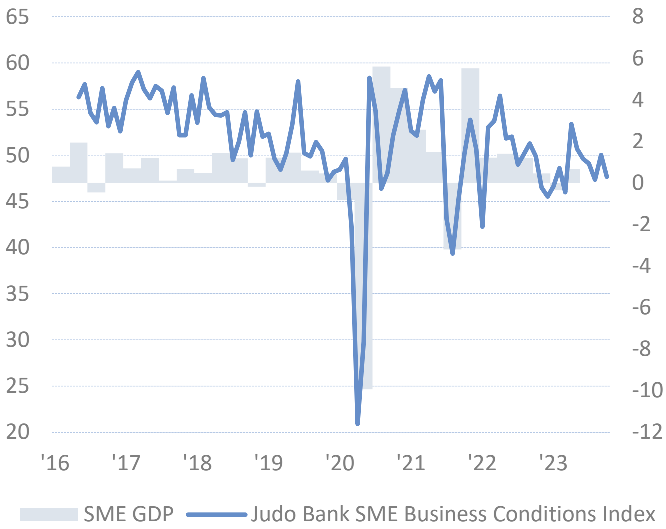
"SMEs operating in the services sector have been experiencing better conditions than those in the manufacturing sector. Although SMEs in the services business saw a slight decline in activity in October, employment and new orders remain stable and slightly above the neutral level. This part of the economy is slowing down, but it's still on track for a soft landing due to the strength of labour demand.

"Manufacturing, in contrast, is contracting at a steeper rate, particularly for SMEs. Output and new orders have fallen below 'soft landing' territory, and labour demand is easing more significantly. We will be watching over the months ahead to see if these levels are more than just volatile movements in the survey data. If the trend continues as the broader economy continues to slow, targeted assistance should be explored through fiscal policy.

"The RBA will likely need to do more work to ensure that inflation returns to target. As a result, we expect SMEs will experience a further softening in consumer demand in both sectors. This in turn would lead to increased pressure on margins and a further reduction in labour demand. However, current figures suggest that SMEs are unlikely to experience a sudden drop in activity, but rather a gradual adjustment."

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.

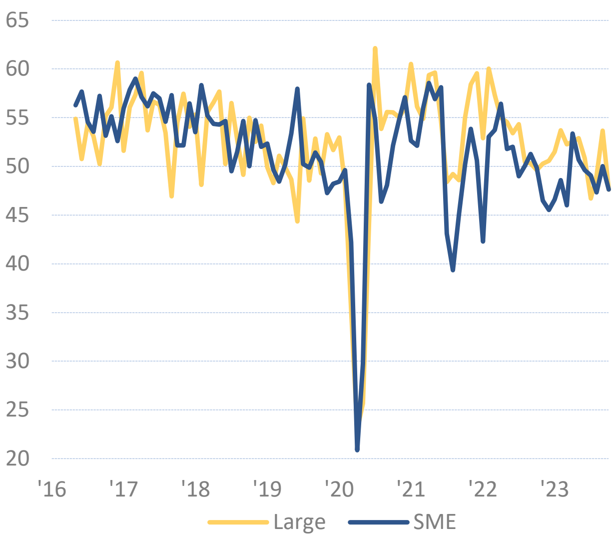
Judo Bank SME Business Conditions Index

sa, >50 = growth since previous month

Sources: Judo Bank, S&P Global PMI.

Judo Bank Business Conditions Index

sa, >50 = growth since previous month



Sources: Judo Bank, S&P Global PMI.

Comment

"SME manufacturing is a genuine weak spot in Australia's economy. Slower domestic demand and persistent cost pressures will be pressuring profitability and, ultimately, viability."

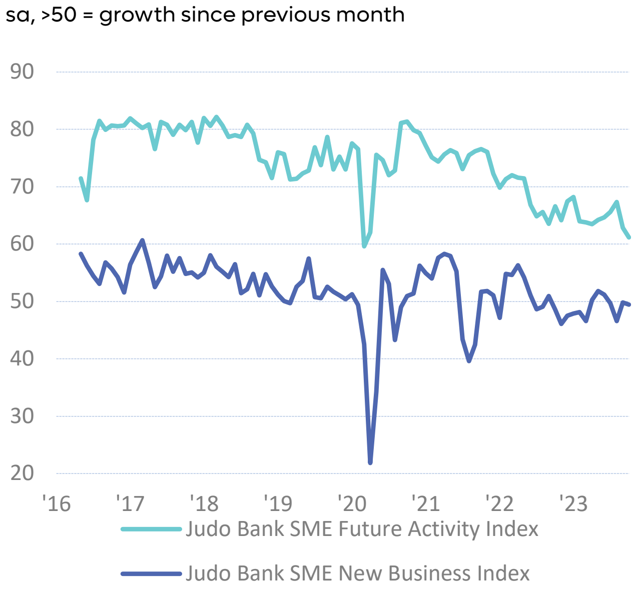
Warren Hogan
Chief Economic Advisor at Judo Bank

Price pressures further eased for Australian SMEs at the start of the fourth quarter.

Demand and outlook

Incoming new orders for goods and services from Australian SMEs fell for a fourth straight month in October. Despite the rate of contraction accelerating slightly from September, it remained marginal and was markedly slower than that for large enterprises. Declines in new work were concentrated on the manufacturing sector, where softening economic conditions negatively affected demand for goods, while service providers saw marginal growth in new business.

Meanwhile, Australian SMEs continued to hold an optimistic view with regards to output in the 12 months ahead. The level of confidence fell to the second lowest on record, however, amid a broad-based easing of confidence in both manufacturing and service sectors. Concerns over the impact of higher interest rates and deteriorating economic conditions heightened among firms in the SME sector.



Sources: Judo Bank, S&P Global PMI.

Comment

"While trending downwards, margin pressures for both SMEs and larger organisations remain elevated on pre-pandemic levels."

Warren Hogan
Chief Economic Advisor at Judo Bank

Employment and capacity

Employment levels marginally declined among SMEs in October following two months of growth. This was driven by a downturn in the goods producing sector, thereby leading to a lowering of manufacturing headcounts. Service providers kept workforce capacity unchanged in comparison, although this followed two successive months of growth, indicating a softening of employment conditions.

Concurrently, the volume of backlogged work fell for a thirteenth straight month in October, albeit only moderately. Excess capacity was more apparent within the goods producing sector, where the level of backlogged work fell at a much sharper rate compared to that of services.

sa, >50 = growth since previous month

Sources: Judo Bank, S&P Global PMI.

Comment

"Labour demand among SMEs is showing signs of easing, particularly across the manufacturing sector."

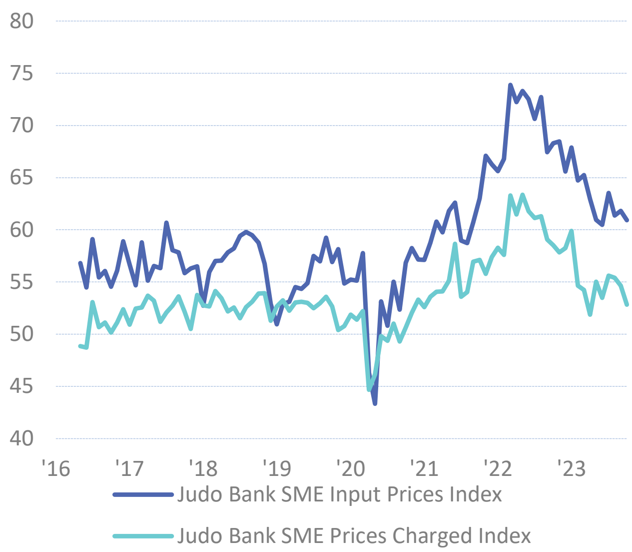
Warren Hogan
Chief Economic Advisor at Judo Bank

Prices

Higher wage, raw material and fuel costs led to average input costs rising again in October. That said, the rate of inflation eased for Australian SMEs, in contrast to the rising inflation trend for large enterprises. Costs rose at the slowest rate since June, as softening price pressures within the service sector more than offset stronger inflation experienced by manufacturers.

As a result of softer input cost inflation, SMEs shared their rising cost burdens at a slower rate with their clients. Moreover, the rate at which selling prices rose dipped below the series average to a six-month low. While services charges rose at a softer rate in October, manufacturing output prices fell for the second time in nearly three-and-a-half years. Some firms reported lowering prices to retain customers and drive sales.

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@spglobal.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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Purchasing Managers' Index™ (PMI®) surveys are now available for over 40 countries and also for key regions including the eurozone. They are the most closely watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends. www.spglobal.com/marketintelligence/en/mi/products/pmi