ECONOMIC UPDATE

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WEEK ENDING 27TH AUGUST 2021

BOQ GROUP

Summary

- Last year saw a jump in the number of companies in Australia;
- Construction is the industry with the highest number of firms. The sector that saw the biggest increase last year was Other Services (repairmen);
- Company exit rates declined in the last financial year driven by government income support and the sharp economic rebound;
- Strong expected capex spending is a sign of firms' confidence about the medium-term outlook.

Each year the ABS release a report on the composition of Australian companies. Construction is the sector that has the largest number of firms. There is a big number of professional, real estate and transport firms. Many companies are 'micro' firms. The industries with the fewest number of companies are either in the government sector or ones that often require large capital investment.

There was a substantial rise in the number of firms in the 2021 financial year. The sector that saw the largest increase in the number of firms over the past year was 'Other Services'. The fear of COVID meant there a big drop in demand for taxis and Uber drivers.

A notable feature is that every year there is a large number of firms that enter and exit an industry regardless of the state of the economic cycle. That is a sign of a dynamic economy.

Entry rates in 2020-21 were near their highest level in over 13 years helped by strong company profitability. That would have also played a role in the sharp decline in exit rates, along with the extremely low level of interest rates, government income support and company debt levels. Over the past five years the sector with the largest entry and exit of firms has been Transport and Administrative Services. The least was farming. Agriculture and mining were the only two sectors where there were more firm exits than entries over the past five years.

'Survival rates for firms that have been in business for a while is around two-thirds. It is tougher for new companies with only about 50% of new firms still in business after 4 years.

Recently a weak Construction Activity report led to some discussion about a low GDP print in the June quarter. A low number would be inconsistent with other evidence from the second quarter. One of the reasons for the softer activity in the construction sector has been that supply has been unable to keep pace with the strong demand

There was positive news that new capital spending by the private sector remained strong in the June quarter. Importantly firms' across most sectors indicate they still intend to have decent sized capex budgets for the rest of this financial year despite the NSW, Victorian and ACT lockdowns. Growth in spending on plant and equipment is expected to be notably strong.

There are more companies in Australia

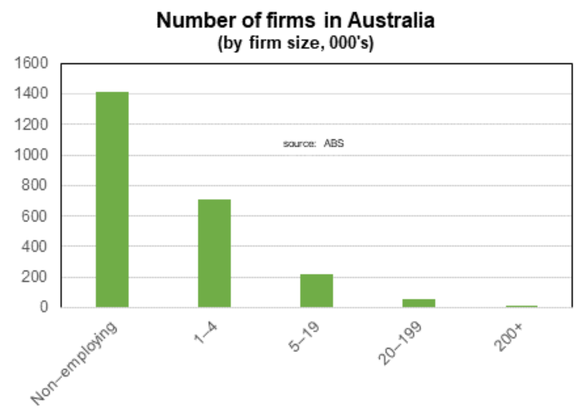
Each year the ABS release a report on the composition of Australian companies. Construction is the sector that has the largest number of firms. There is a big number of professional (IT consultants, accountants), real estate and transport (Uber and taxi drivers) firms. We also have a fair few farmers. Many companies are 'micro' firms (those employing 4 workers, or less). The industries with the fewest number of companies are either in the government sector or ones that often require large capital investment (such as mining, utilities, telcos).

There was a substantial rise in the number of firms in the 2021 financial year. Maybe those long lockdown days stirred up thoughts of entrepreneurship. The incentives to start your own business was high given that many firms were profitable last year (a reflection of the sharp bounce-back in economic growth and Government income support payments). Strong business conditions and government income support was also why there was a drop in the number of firm exits.

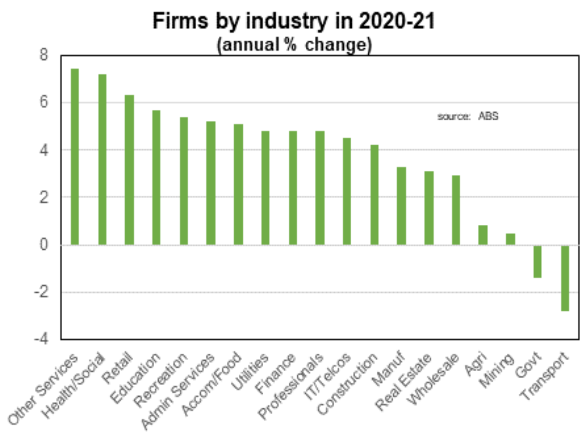
The sector that saw the largest increase in the number of firms was 'Other Services'. Being stuck at home meant people wanted to spruce up the house, leading to greater demand for repairmen (and women). The NDIS scheme has been the driver of a large number of new companies. And the boom in spending last year underpinned the rise of many new retailers. By contrast fear of COVID meant there a big drop in demand for taxis and Uber drivers.

Construction and professional services are the sectors with the largest number of firms.

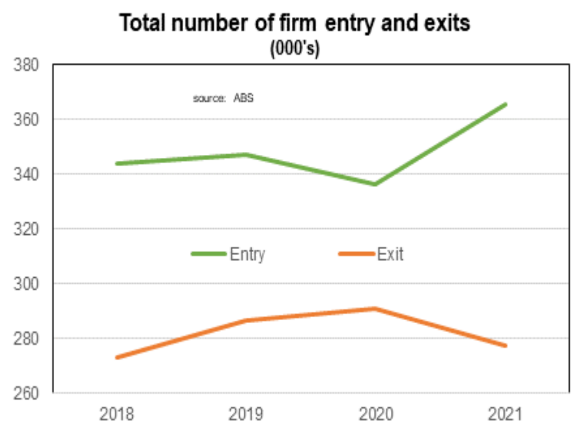
The majority of firms have few employees.



The biggest increase in the number of firms was in the Other Services and Health and Social Welfare sectors.



Strong business conditions underpinned a rise in company entrants and fall in exits.

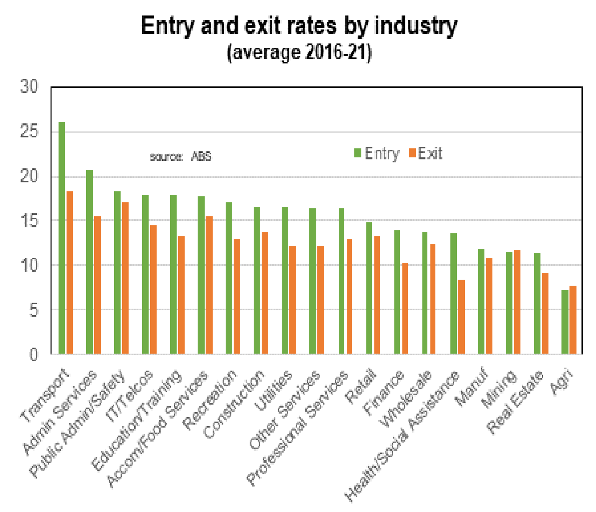


A notable feature is that every year there is a large number of firms that enter and exit an industry regardless of the state of the economic cycle. A bit of that is down to people starting up a company while they are 'between jobs' (and closing it down when they have found that job). But the large number of entry and exits is also a sign of a dynamic economy. Changing technology and consumer tastes demands firms evolve the way they provide goods and services to their customers (and their pricing).

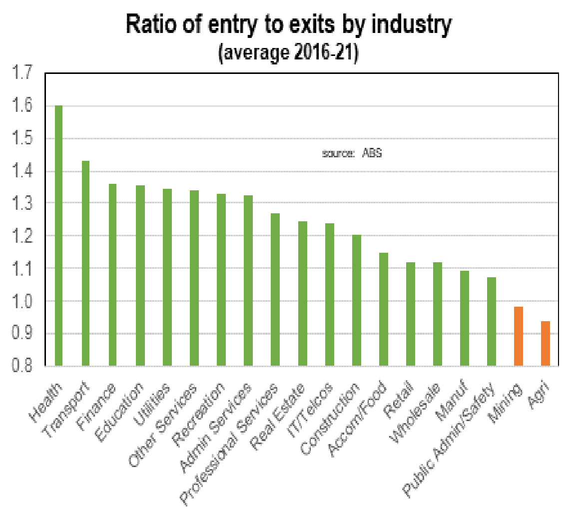
Entry rates in 2020-21 were near their highest level in over 13 years helped by strong company profitability. That would have also played a role in the sharp decline in exit rates, along with the extremely low level of interest rates, government income support and company debt levels. Exit rates have declined amongst small and medium-sized employing firms but have remained relatively stable amongst non-employing and large firms.

Over the past five years the sector with the largest entry and exit of firms has been transport (Uber drivers) and Administrative Services (employment services, call centres). The least was farming (reflecting the difficulty in finding and being able to afford decent farming land). Agriculture and mining were the only two sectors where there were more firm exits than entries over the past five years.

There has been plenty of movement of firms in and out of the Transport sector. Less so in Agriculture.



Only Agriculture and Mining saw more firm exits than enter over the past five years.

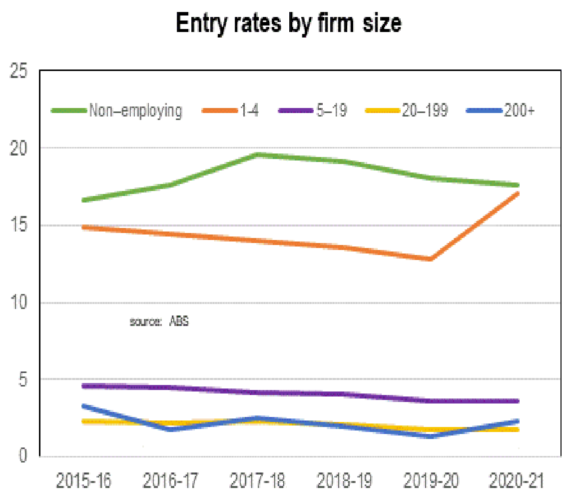


'Survival rates for firms that have been in business for a while is around two-thirds. It is tougher for new companies with only about 50% of new firms still in business after 4 years. Over the past four years 'survival rates' have been highest for farmers (helped by high commodity prices). High profit margins and strong demand have helped keep firms going in the health and social welfare and real estate sectors.

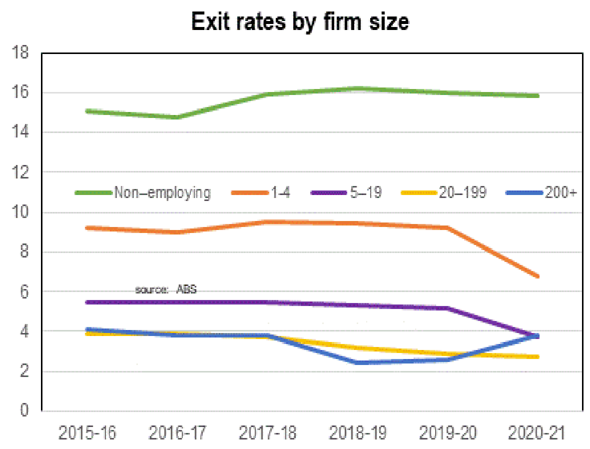
Survival rates have been relatively low in Transport, partly reflecting that a portion of Uber drivers may start a company until they find other employment. Survival rates have also been relatively lower in the Accommodation and Food services industry as that sector faces tight margins, tough competition, long hours and (most recently) the impact of COVID.

Over recent years Entry rates have been rising and exit rates declining.

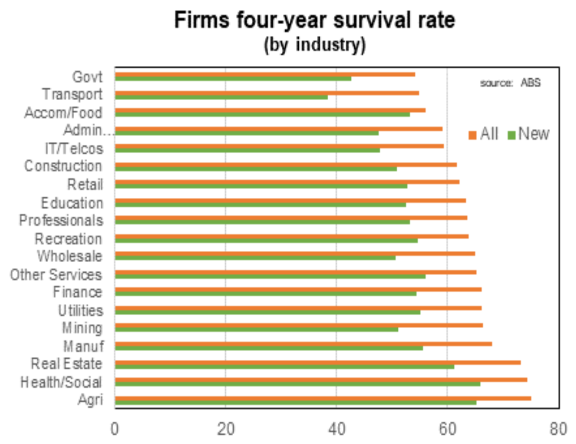
Over recent years entry rates have picked up amongst the smallest firms.



And the smaller firms have also seen a decline in their exit rates.



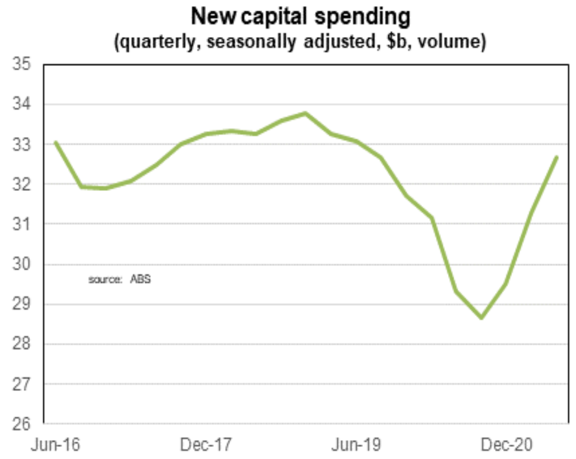
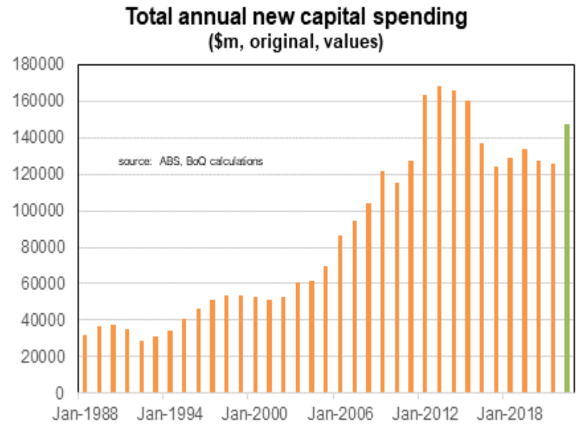
Firms are more likely to survive in agriculture but find it tougher in transport.



Firms are expecting better times ahead

Recently a weak Construction Activity report led to some discussion about a weak GDP print in the June quarter. A low number would be inconsistent with other evidence from the second quarter including firms' reporting that business conditions were at their best in at least two decades, positive consumer sentiment, plenty of job vacancies, a falling unemployment rate and analysts debating the timing of the first interest rate hike. One reason for the softer activity in the construction sector is that the supply (of builders, tradies and materials) has been unable to keep pace with the strong demand

We also received the positive news that new capital spending by the private sector remained strong in the June quarter. Importantly firms' across most sectors indicate they still intend to have decent sized capex budgets for the rest of this financial year despite the NSW, Victorian and ACT lockdowns. Growth in spending on plant and equipment is expected to be notably strong. The positive sentiment towards capex spending indicates confidence in the medium-term economic outlook. It is also a sign of the benefit of extremely low interest rates and government tax incentives.

Capital spending is bouncing back.	And is in track to be even stronger this financial year.
	

We live in interesting times.

Regards,

Peter Munckton
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Bank of Queensland