ECONOMIC UPDATE

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WEEK ENDING 19TH FEBRUARY 2021

Summary

- SME confidence has risen over recent months;
- Further improvements are likely this year as the economy continues to recover;
- The number of start-up SME's though might be low at least until COVID is in the rear-view mirror;
- Improving productivity at SME's is important for the Australian economy.

The performance of SME's matters for Australia as they comprise a larger share of all businesses than many peer countries. An area of concern for Australia though is that according to the OECD SME's are a lot less productive than larger firms.

The better economy was felt by firms of all sizes and across all industries. But improving does not mean that things couldn't be better, particularly for smaller businesses. According to ABS data, the number of workers on small firms' payrolls is comfortably below their peak level of last year. And the Northern Beaches lockdown and the recent scare in Melbourne would not be helping small company's mood.

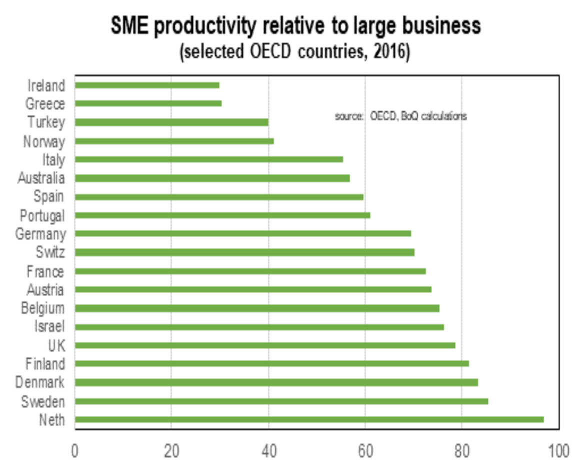
At the end of last year bankruptcies were at twenty-year lows. This was one reason why the proportion of firms exiting was down a little across the economy in 2019-20. Less encouraging was that for the second consecutive year the proportion of new firms in the economy declined.

The stronger economy means better times for companies of all sizes. But the proportion of start-ups in the economy might be low for a while, at least until it is clear that the COVID-driven funk has left the economy. In the longer term improving productivity will be important for SME's. The first step in this journey for many SME's might have already begun with the increasing shift towards digitisation.

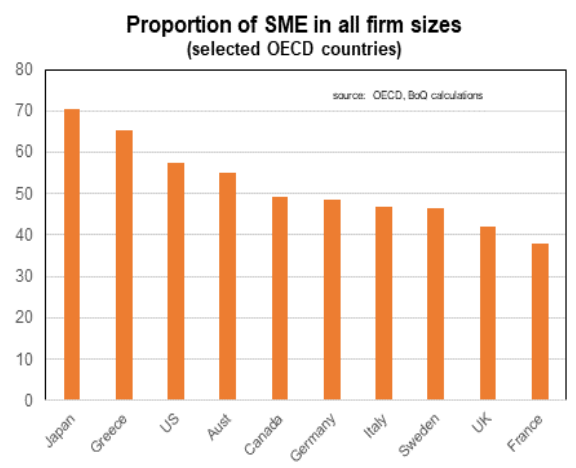
SME's are feeling better

The performance of SME's matters for Australia as they comprise a larger share of all businesses than many peer countries. This might reflect that Australia has a smaller manufacturing sector, a scale industry that typically favours bigger companies. It might also reflect that Australia has less regulations than many European countries making it easier for smaller firms to compete. An area of concern for Australia though is that according to the OECD SME's are a lot less productive than larger firms.

SME productivity relative to larger firms is lower in Australia.



Australia has a relatively high proportion of SME's.



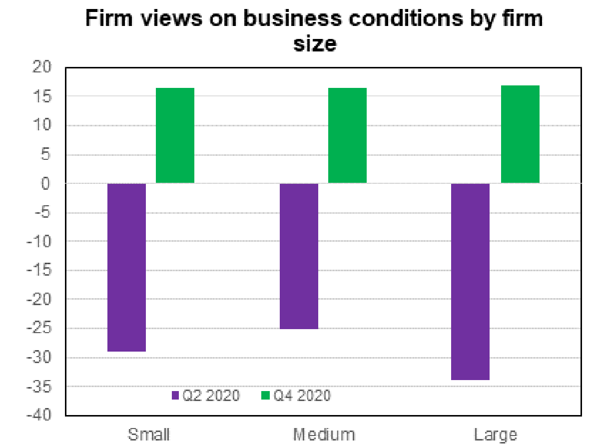
The big story of the last few months of 2020 was the perkiness of the economy. A reasonable amount of the credit for the better economy can go to the massive support from monetary and (especially) fiscal policy. An even bigger factor was that after being essentially shut in Q2 the economy ex-Victoria opened up in Q3. And then Victorian restrictions were eased in Q4.

The better economy was felt by firms of all sizes and across all industries. For SME's, confidence by property and business-service firms spiked towards the end of the year as clients began to spend again. Confidence also picked up in the restaurant and accommodation sector reflecting the decent state of household balance sheets as well as their desire to get out of the house. Confidence was strongest in the health sector, as people were happy to again visit their doctor or dentist.

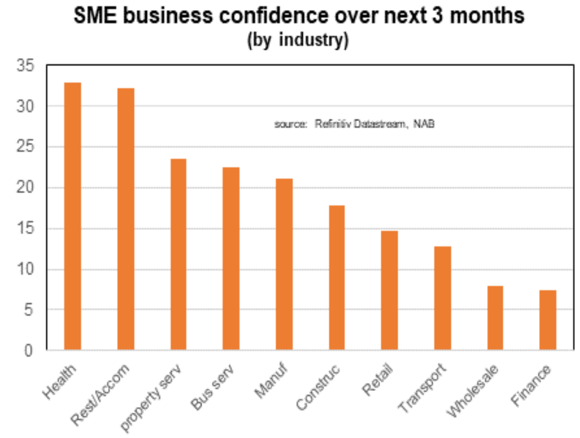
So things for SME's are improving. But improving does not mean that they are good, particularly for smaller businesses. According to ABS data, the number of workers on small firms' payrolls is comfortably below their peak level of last year. And the Northern Beaches lockdown and the recent scare in Melbourne would not be helping small company's mood.

At the same time a rising number of SME's are indicating that it is hard to find the right-skilled workers. Border closures have made it harder to find the right type of workers (such as seasonal agricultural workers). And there is strong demand for employees in certain sectors (such as bricklayers and infrastructure engineers).

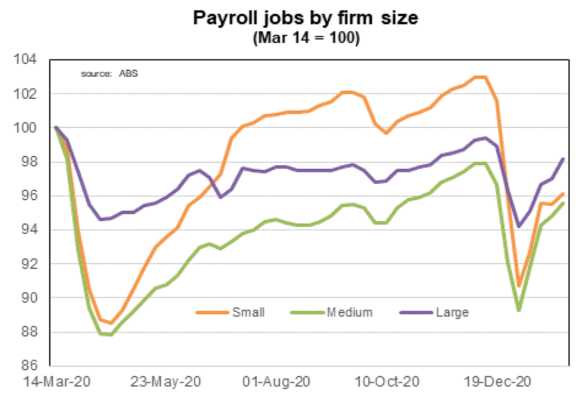
Firms' of all sizes agree that things are getting better.



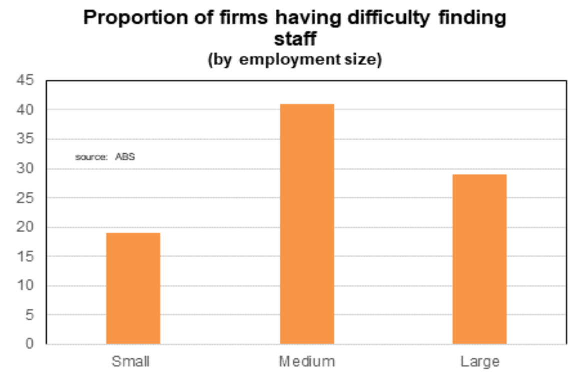
As are SME's across sectors.



Payroll jobs at small firms are well below their peak.



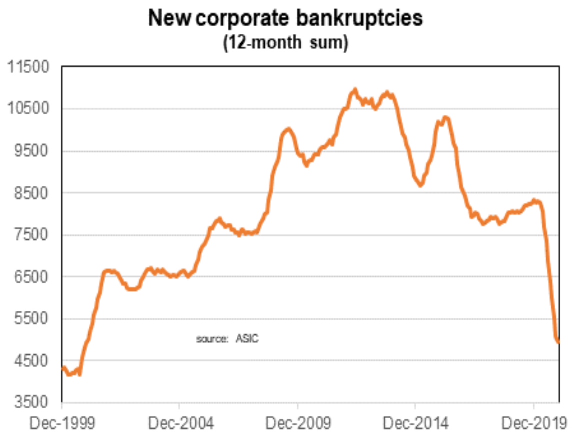
But an increasing number of firms are finding hard to get good staff.



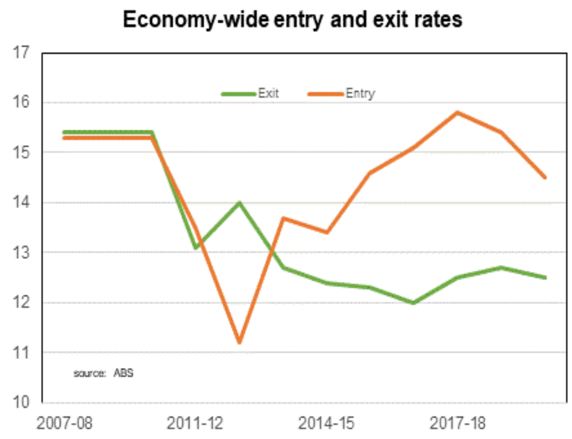
But the glass is half full. At the end of last year bankruptcies were at twenty-year lows. JobKeeper and interest rate/tax payment holidays worked their magic by supporting the economy. Rock-bottom interest rates made it easier to finance debt. And the pause in the insolvency regime meant those that were doing it tough were given a chance to get things right.

This was one reason why the proportion of firms exiting was down a little across the economy in 2019-20. Less encouraging was that for the second consecutive year the proportion of new firms in the economy declined. This is no big surprise. It is tough opening a business at the best of times. But it is very hard during a period when the economy experienced its most significant downturn since the Great Depression. The uncertain economic environment means that a further fall in the proportion of new firms is likely this financial year.

Bankruptcies in 2020 were at twenty-year lows.



Both firm entry and exit rates were down last financial year.

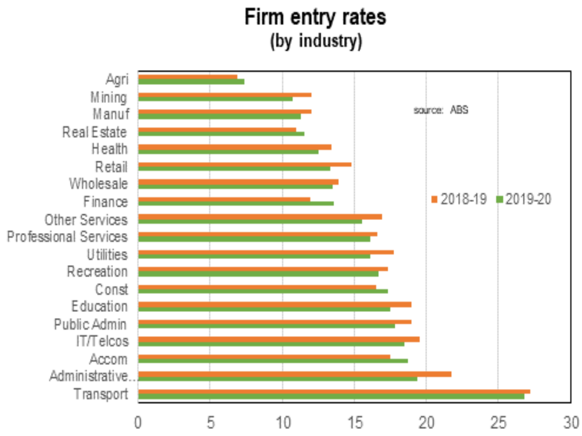


The story is a little better when examining the sectoral data. In some industries exit rates (notably Transport and Accommodation) fell substantially in 2019-20, two of the sectors hardest hit by COVID.

The proportion of new firms was down across most sectors. But there were more farmers reflecting the better rains and the generally stronger performance of regional economies. While there was a fall in the number of specialist beef or sheep farmers there was a rise in the number doing mixed farming (such as doing both beef and sheep). There was also more Uber drivers (particularly those delivering food). There was a rise in the number of management consultants. The shift to digitisation meant there was plenty of room for new IT companies. Ditto engineers looking to do work in the infrastructure space. More doctors set up a business in 2019-20.

Over the past five years exit rates have been declining for medium- and large-sized firms but have been flat for smaller companies. Over that time smaller firms would have been more impacted by the modest growth in consumer spending (constrained by the extended run of weak wages growth). The proportion of new companies has been declining across all firm sizes (apart from non-employing companies) but notably so for the smallest companies.

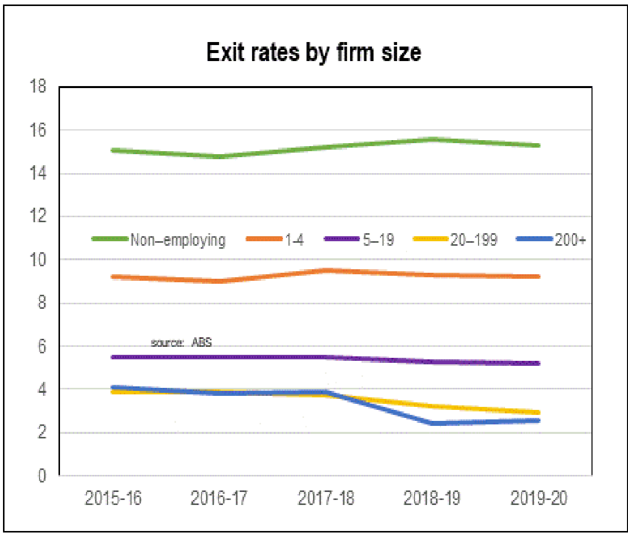
Entry rates declined across most sectors.

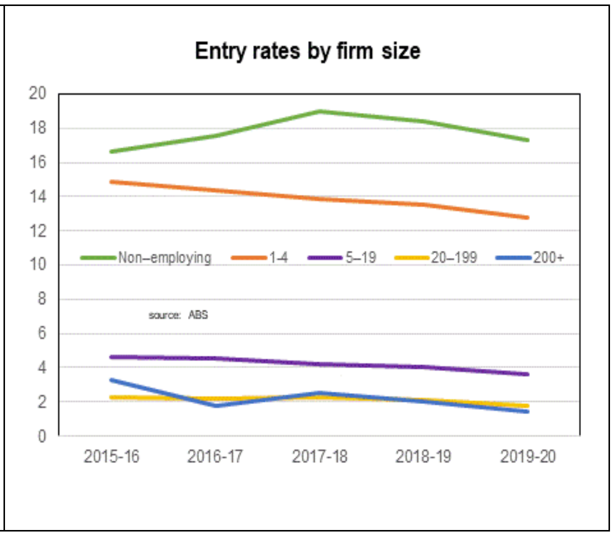


But so did exit rates.

Exit rates has been falling for medium- and large-sized firms.

But entry rates have been on the decline for most company sizes.





All up the stronger economy means better times for companies of all sizes. The improvement in consumers' disposable incomes should be good news for many SME's. But the proportion of start-ups in the economy might be low, at least until it is clear that the COVID-driven funk has left the economy. In the longer term improving productivity will be important for SME's. The first step in this journey for many SME's might have already begun with the increasing shift towards digitisation.

We live in interesting times.

Regards,

Peter Munckton
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