

Comment

Rebalancing nipped in the bud as survey results highlight strain

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Background to the BER business surveys

A cornerstone of the BER's work is its regular business surveys. The BER's survey method is modelled on those of the European Commission and Munich based IFO Institute. The survey data has a proven track record as exceptionally reliable – given the correspondence with the available formal statistics – and provides unique information such as confidence, rating of business conditions and respondents' expectations for the next quarter. Finally, the survey data has a publishing lead i.e. the results reveal the direction of production, sales, selling prices, employment etc. before the release of official data.

The aim of this note is to summarize some specific insights from the current round of BER surveys in the trade, manufacturing and building industries, to be used as a first indication of likely developments in the real economy during 2014Q2 (until official data become available) and beyond. More detailed sectoral analyses are provided in the respective BER survey publications.

Please note that the information provided is under embargo until the respective survey publications are released on the BER's website.

Introduction

Although the RMB/BER Business Confidence Index (BCI) remained unchanged at a low level of 41 index points during 2014Q2¹, the underlying results portray a different picture than in Q1. The hope of a possible start of the rebalancing of the economy in favour of the construction and manufacturing sectors, which was fuelled by trends in official data in the second half of 2013 and the buoyant fixed investment and export indicators in Q1, was dashed this quarter. Not only is the manufacturing sector clearly taking strain, with fixed investment and export indicators deteriorating, but the building sector results also signalled a halt of the expansion in non-residential building activity. Manufacturing confidence dropped sharply from 41 to 25 index points and the level of confidence of building contractors declined slightly. While the confidence of retailers and new vehicle dealers rose significantly, underlying indicators of sales volumes do not signal an improvement in activity. Wholesalers reported a slightly lower level of confidence.

¹ The second quarter survey was conducted between 5 May and 2 June 2014.

The second quarter had a number of features that may have impacted negatively on general business conditions. These include the continuation of the strike in the platinum mining sector, industrial electricity users having to cut back on electricity usage as supply came under pressure, as well as the low level of trading days due to various public holidays. In all, the survey results imply that economic growth will remain weak during Q2.

Activity indicators

Building sector activity deteriorates on both the residential and non-residential side

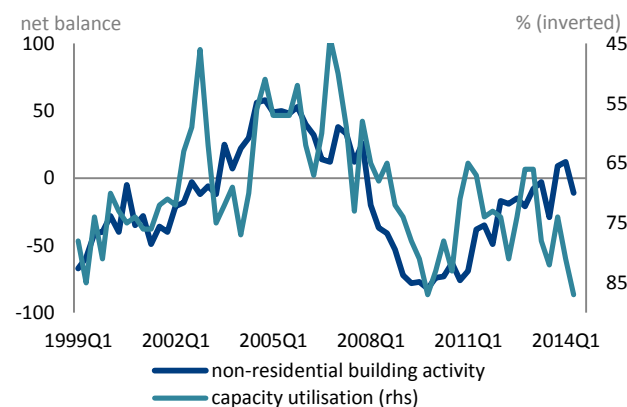
After gaining some momentum last year, the recovery in building activity seems to have halted in Q2. Residential building activity, which has been underperforming, seemed to pick up during 2013 – supported by a recovery in house prices and an easing of bank's mortgage loan criteria. However, the survey indicator for residential building activity dipped during Q1 and remained low (actually falling slightly further) in Q2, see Figure 1. The tighter mortgage loan lending criteria of banks following the South African Reserve Bank's (SARB's) increase in the interest rate in January and pronouncements that more increases are to follow probably cut short the emerging recovery in residential building activity.

Figure 1: Residential building activity



Sources: BER, ABSA

Figure 2: Non-residential building activity



Source: BER

Non-residential building activity which has been on a steeper recovery path and improved further during Q1, dipped noticeably in Q2. The indicator for non-residential building activity had been more positive than one would have expected in relation to a proxy for general capacity utilisation in the second half of 2013 – as shown in Figure 2 using the (inverted) percentage rating current level of output below capacity in the manufacturing sector survey.

The pipeline of non-residential projects seems to have slowed significantly. The rating of insufficient demand and tendering competition from these contractors rose sharply. Furthermore, architects and quantity surveyors also reported a drop in commissions at working drawing stage. For the manufacturing sector in particular (as argued in the March comment), some of these investments were aimed at replacing existing capacity. It, however, seems that this has run its course, with the indicators for manufacturing investment deteriorating in Q2.

Manufacturing sector clearly taking strain

It is argued below that not only is the protracted strike in the platinum mining sector taking its toll on the domestic manufacturing sector, but that the sector is also facing headwinds in key sub-divisions such as the transport equipment and basic metals sectors. The performance of the non-metal minerals industry also deteriorated noticeably in Q2, echoing the deterioration in building sector activity.

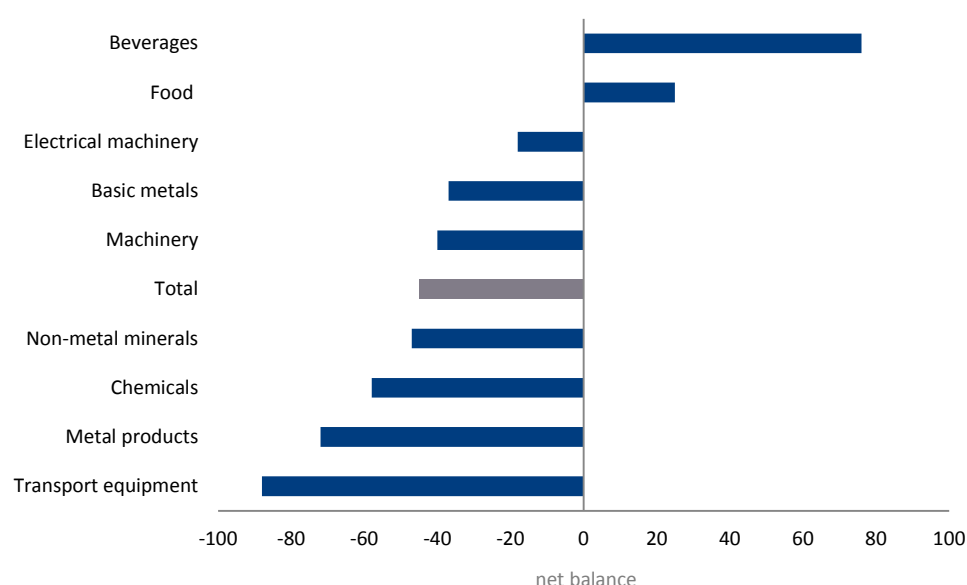
Table 1: Share of manufacturing output destined for the mining sector in 2013

	Total mining	Coal	Gold	Other
Total manufacturing	5.08	1.37	0.61	3.11
Non-metal minerals	3.01	0.96	0.58	1.46
Transport equipment	3.70	1.04	0.23	2.42
Electrical machinery	5.93	2.40	0.57	2.96
Petroleum, chemicals, rubber and plastics (other chemicals)	6.21 (8.61)	1.63 (2.18)	0.59 (0.86)	4.00 (5.56)
Metal products	9.22	2.61	1.25	5.36
Machinery and equipment	20.05	5.04	1.91	12.75

Source: Quantec

Table 1 indicates the share of manufacturing output that is delivered to the mining sector for total manufacturing and a selection of sub-divisions. The industries most closely tied to the platinum mining sector (see "Other") are: machinery and equipment, metal products as well as petroleum, chemicals, rubber and plastics (in particular the "other chemicals" sub-division). As shown in Figure 3, these industries reported a contraction in domestic sales volumes (and also domestic order volumes) during Q2.

Figure 3: Manufacturing domestic sales volume indicators



Source: BER

However, other key sub-divisions of manufacturing such as the transport equipment and basic metals industries are also taking strain on the domestic demand side. Both domestic sales and exports of vehicles are currently contracting. Total domestic vehicle sales declined by more than 9% year-on-year (y-o-y)

during May (as reported by the dti/Lightstone Auto). Passenger car sales, the largest component, was down -11.3% y-o-y. Vehicle export volumes declined by 40.3% in May on the back of a discontinuation of a major export model by a prominent vehicle manufacturer as well as the retooling of another major manufacturing plant (mentioned in a statement by the National Association of Automobile Manufacturers of South Africa – NAAMSA). The basic metals industry is not only adversely affected by these trends and the slowdown in building activity, but was also subject to power cutbacks during Q2.

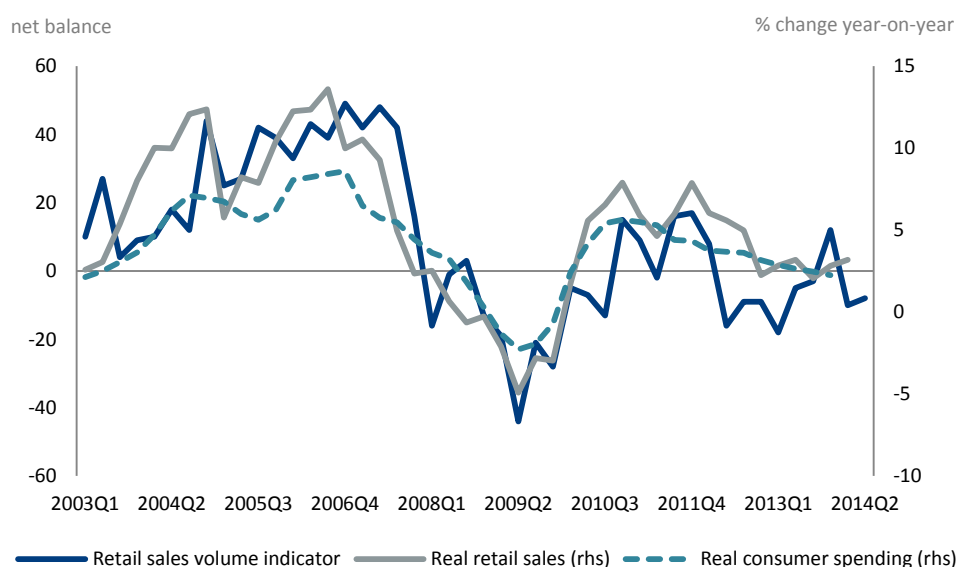
There were, however, still some pockets of strength in the manufacturing sector. Manufacturers of consumer goods (in particular food and beverages) reported the highest levels for the demand and production indicators. This corresponds with the retail trade results for the non-durable consumer goods sector – see below.

Activity remains relatively soft in the trade sectors

Although retailer business confidence increased, underlying business conditions remain challenging. The confidence increase seems to be driven by an improvement in profitability and a slightly better than expected realisation of Q2 sales volumes. There is also a slight divergence between retail groupings, with retailers of non-durable and durable (other than motor cars) goods reporting an improvement while sales volumes of semi-durable goods seem to be under pressure.

Overall growth in the volume of sales remained relatively weak and is consistent with official retail trade volumes as published by Statistics South Africa (Stats SA) of below 3% in Q2, as shown in Figure 4. There is also scope for a further deceleration of real consumer spending data to be published by the SARB for Q1 and Q2.

Figure 4: Retail trade sales volumes



Sources: BER, Stats SA, SARB

No further deterioration in employment indicators

The survey indicators for employment in all the major sectors rose slightly during Q2, from low levels in the first quarter, but are expected to dip again slightly in Q3. The average of these indicators across the building, manufacturing and retail sectors points towards a continuation of weak growth in formal employment during this year (already a feature of the BER's macroeconomic forecast). See Figure 5 which plots this indicator against growth in employment according to the Quarterly Labour Force Statistics (QLFS) and the Quarterly Employment Statistics (QES), both published by Stats SA. The BER employment indicators are theoretically more closely correlated with the QES growth rates (the latest of which are for 2013Q4) since the surveys cover the formal sector.

Figure 5: Survey indicators continue to signal weak employment growth in 2014



Sources: BER, Stats SA

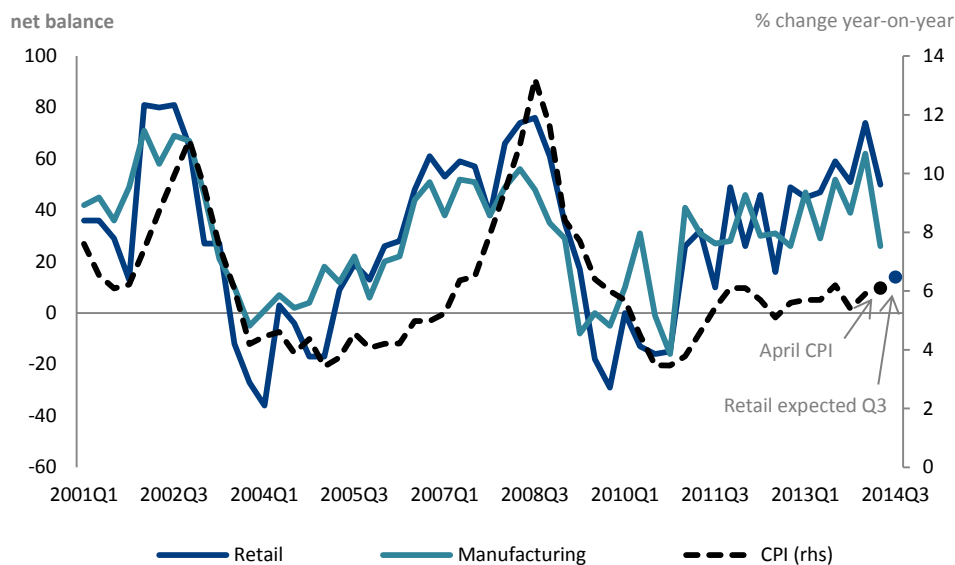
Purchasing and selling prices decelerate significantly

In contrast to the previous survey round when price pressures intensified noticeably across all sectors, the current results yielded a broad-based deceleration in purchasing as well as selling price inflation indicators. The only exception to the decline in cost price pressures was that the rate of increase in the average total cost per unit of production in the manufacturing sector accelerated in Q2. This increase was the result of higher average unit labour cost inflation.

Even though these surveyed indicators of prices have been volatile in the post-recession period, the latest downward move is relatively large – particularly on the trade (wholesale and retail) sector side. Moreover, expectations are that selling price inflation will decelerate significantly further in Q3. Figure 6 shows these indicators alongside CPI inflation. The decline in the survey indicators have gone some way in closing the gap between the indicators and CPI inflation (as analysed in the March comment), and should retail sector expectations for Q3 materialise, the gap would have disappeared. The current readings imply that a

further upward adjustment to the BER's forecast for CPI inflation is not necessarily warranted at this stage. However, pass-through of exchange rate and labour cost pressures will have to be constantly monitored as these continue to pose a risk to the inflation outlook.

Figure 6: Selling price indicators and CPI inflation

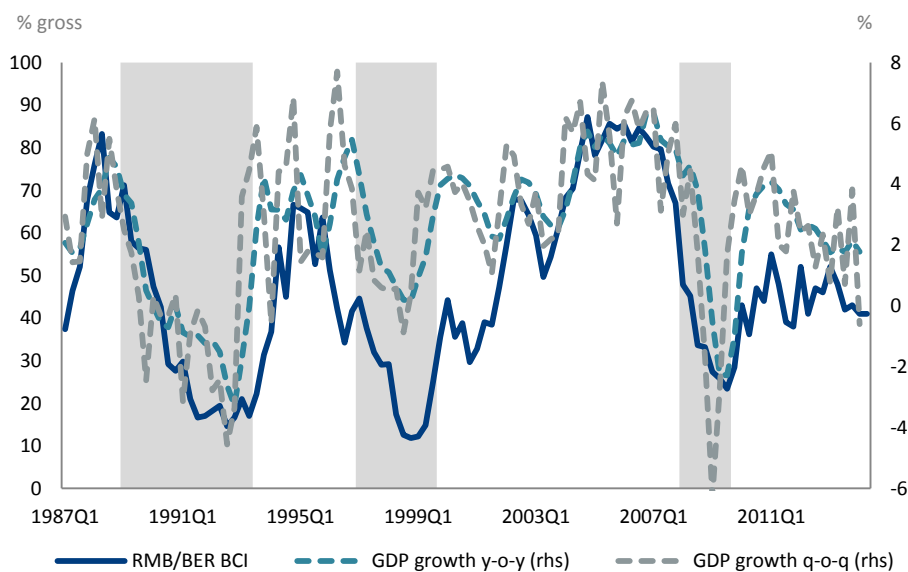


Sources: BER, Stats SA

Implications

The survey results imply that GDP growth is likely to remain weak during Q2. Figure 7 presents the RMB/BER BCI and GDP growth.

Figure 7: RMB/BER BCI and GDP growth



Sources: BER, Stats SA, SARB

The possible start of a rebalancing of the economy away from the trade sectors in favour of more sustainable growth boosted by fixed investment and production was nipped in the bud during Q2. Although the economy has had to face several specific headwinds in Q2 – the continuation of the platinum mining sector strike, electricity cutbacks and various additional public holidays – general momentum in economic growth also remained relatively slow. It remains to be seen whether the economy enters a technical recession (i.e. two consecutive quarters of contractions in GDP) in Q2 when the estimate for GDP is published by Stats SA late August. While there certainly is a chance that the quarter-on-quarter (seasonally adjusted and annualised) growth rate could again be negative, the bulk of the sectors of the economy will not technically be in recession (an alternative definition of recession is one where most of the sectors of the economy must be contracting). A broader business cycle analysis which includes the BER survey indicators also does not confirm broad-based signals of recession at this stage.

However, taking the disappointing Q1 GDP reading together with the continuation of strike activity, the weakening of the outlook for the manufacturing sector and the deterioration in the building sector, it is very likely that GDP growth will average below 2% this year. The BER formally updates its macroeconomic forecast towards the end of June. Table 2 provides a summary of the implied risks to the current forecast as published early April based on the survey results and other recent information.

Table 2: Risks to the BER's April macroeconomic forecast

Key:	Surveys highlight <u>downside</u> risk to current BER forecast	Surveys highlight <u>mild downside</u> risk to current BER forecast	Survey information in line with current BER forecast	Surveys highlight <u>mild upside</u> risk to current BER forecast	Surveys highlight <u>upside</u> risk to current BER forecast
Final Consumption Expenditure, Households (neutral)					
Gross Fixed Capital Formation (mild downside risk)					
Exports (downside risk)					
GDP: Gross Domestic Product (downside risk)					
Employment (neutral to mild downside risk)					
CPI: Consumer inflation (neutral)					
PPI: Producer inflation (neutral)					

Source: BER

Christelle Grobler

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