

Comment

Survey results hint at the possible start of a rebalancing of the economy

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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 2014Q1 (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

Business confidence declined slightly in 2014Q1¹ and is currently at a relatively low level. The RMB/BER Business Confidence Index (BCI) dropped to 41 index points (from 43 previously). Hence, currently around six out of ten businesses are unsatisfied with business conditions. New vehicle dealers reported a particularly sharp downward adjustment in confidence. Retailer confidence levels remained more or less unchanged while wholesaler confidence declined somewhat. On the other hand, business confidence rose in the manufacturing and building (contractors) sectors. In fact, it is the first time since 2008Q1 that the building sector registered the highest confidence levels of the sectors included in the RMB/BER BCI², albeit that the level of confidence of building contractors is still relatively low.

¹ The first quarter survey was conducted between 3 February and 3 March 2014 and was therefore completed before the first countrywide power cuts since 2008 occurred on 6 March 2014. The BER's survey consults about 2 500 firms.

² See the [RMB/BER BCI press release](#) for a more detailed description of trends in business confidence per sector.

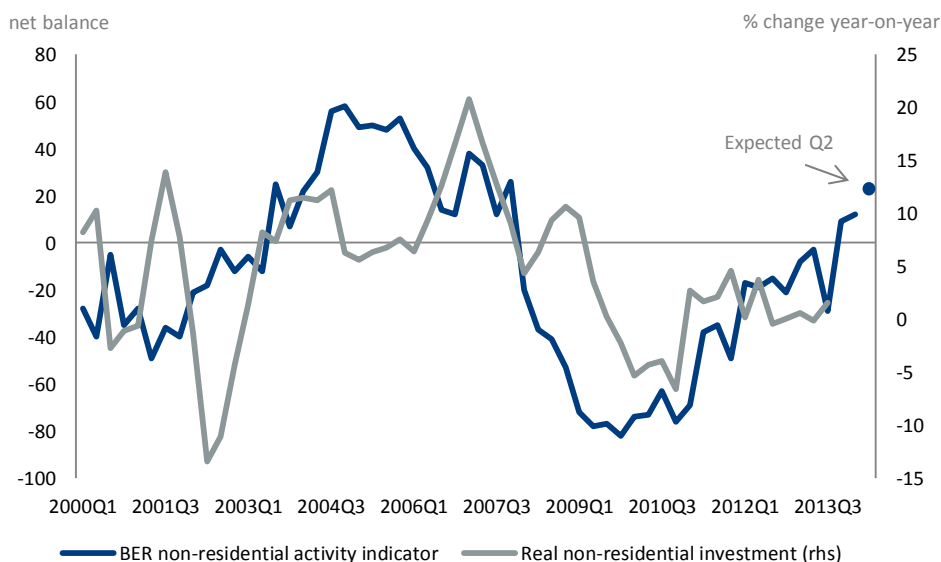
Underlying survey indicators mostly supported this rebalancing of business confidence levels with activity in the non-trade sectors outperforming. The survey results provided evidence that manufacturing fixed investment – and in fact non-residential fixed investment in general – might be more buoyant than expected. Furthermore, the manufacturing export indicators not only signal a strong performance during Q1, but forward looking export indicators are also at high levels. These activity indicators, as well as other noteworthy results and their implications, are unpacked below.

Activity indicators point towards a rebalancing

Barring the residential sector, fixed investment trends are more positive than expected

The building sector survey results were somewhat of a mixed bag, with the residential sub-sector underperforming while the non-residential sub-sector results showed signs of a more buoyant than expected recovery. After improving during 2013Q4, the indicator for growth in non-residential building activity, as reported by contractors, increased to its highest level since 2007Q4. Moreover, these contractors are very positive with respect to building activity during Q2. Although the South African Reserve Bank (SARB) data for growth in real non-residential fixed investment is relatively volatile, the survey results indicate that one might expect some upward momentum in this data over the next two to three quarters (latest actual data is for 2013Q3) – see Figure 1.

Figure 1: Non-residential fixed investment

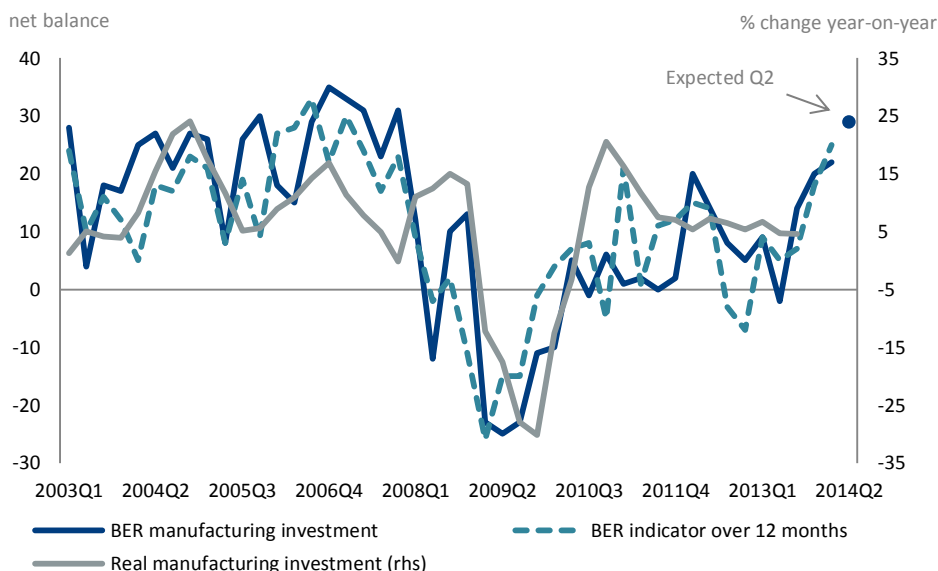


Sources: BER, SARB

The manufacturing sector results also portrayed a rather positive picture with respect to fixed investment, with indicators also at the highest level since 2007. Not only was the current quarter total fixed investment indicator high (after also registering a relatively high level in 2013Q4), but expectations are that growth in total fixed investment will accelerate further in Q2 as well as in 12 months' time. These indicators are plotted against real growth in manufacturing fixed investment as published by the SARB in Figure 2. After

hovering between 5 and 6% year-on-year (y-o-y), there might also be scope for an acceleration in official real manufacturing fixed investment growth.

Figure 2: Manufacturing total fixed investment



Sources: BER, SARB

The underlying survey indicators imply that these investments by manufacturers are aimed towards machinery and equipment to replace (upgrade) current capacity instead of adding to production capacity. This is consistent with other evidence such as a high percentage rating the current level of output below capacity (i.e. relatively low capacity utilisation in the manufacturing sector). It could also be aimed at replacing labour given high costs and output disruptions³ and/or the result of technological advances in global manufacturing⁴ necessitating local firms to become more capital intensive to be able to compete internationally.

Manufacturing export performance improved further

The rand value of manufacturing exports increased by around 12% y-o-y during 2013. According to the latest preliminary trade statistics as released by the South African Revenue Service (SARS), growth accelerated further to almost 29% y-o-y during January 2014. After also ticking up in 2013Q4, the BER indicators for manufacturing export sales and order volumes rose sharply during Q1. In fact, these indicators are currently at their highest level since 2002 and 1995 respectively. See Figure 3.⁵

Although export selling prices accelerated, these indicators point towards a notable increase in manufacturing export volumes. It must be highlighted that the fact that the rand exchange rate is trading

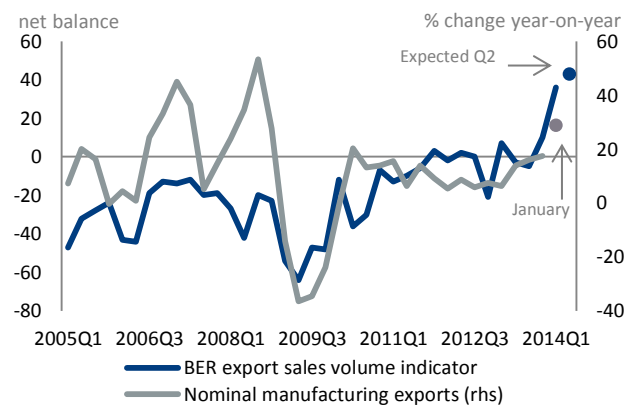
³ This **BER Research Note** provides an overview of employment trends in the manufacturing sector.

⁴ See this **interesting article** on the future of manufacturing in advanced economies.

⁵ Although there has been a structural break in the relationship between the BER indicator for sales volumes and the official trade statistics before and after the recession, these data do track over time. The scale was set as to maximise the fit of the post-recession period.

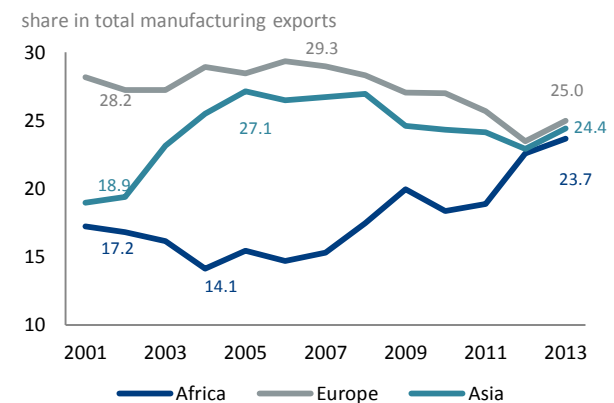
at weaker levels while global economic growth is improving, presents a particularly favourable situation for exporters (usually our currency strengthens when global growth accelerates). Weak domestic demand also forces manufacturers to look more to export markets. Not only are conditions improving for our traditional trading partners in Europe, but manufacturers have also managed to shift their export markets more towards faster growing regions – such as Africa – and seem to be reaping the benefits. Figure 4 illustrates the share of exports to certain regions as a percentage of total manufacturing exports over the last decade.

Figure 3: Manufacturing exports



Sources: BER, SARS

Figure 4: Destination of manufacturing exports

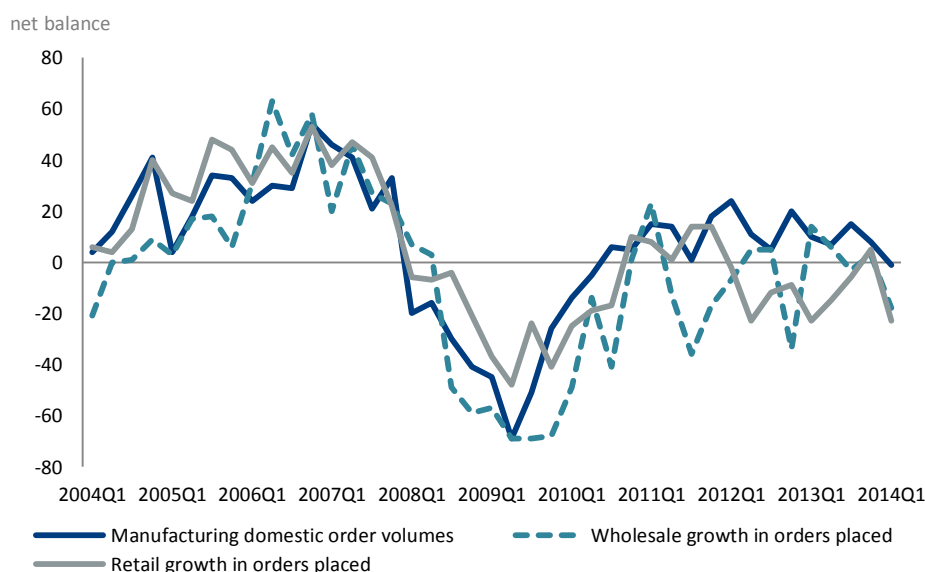


Sources: Quantec Research, BER calculations

Domestic demand indicators are consistently weaker

The BER indicators relating to domestic demand consistently registered weaker levels across the manufacturing, wholesale and retail sectors. Wholesalers and retailers witnessed a slowdown in sales volume growth and reported an accompanying deceleration in the growth of orders placed.

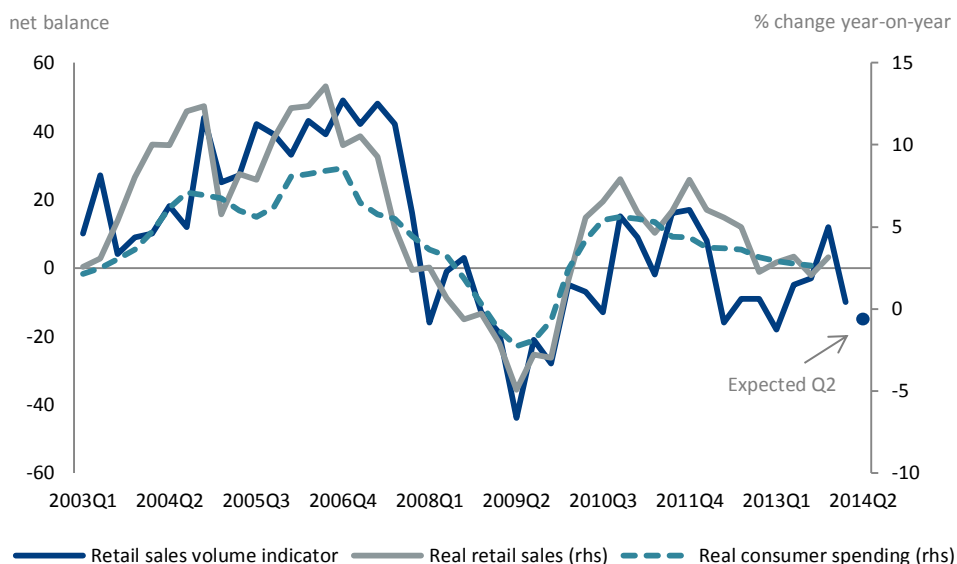
Figure 5: Domestic demand indicators



Source: BER

The indicator for manufacturing domestic order volumes dropped to its weakest level since 2011, see Figure 5. Realised levels of sales surprised respondents on the downside during Q1. While wholesalers and manufacturers again expect an improvement in orders, retailers seem to have adjusted their expectations and are relatively pessimistic regarding expected growth in sales volumes in Q2.

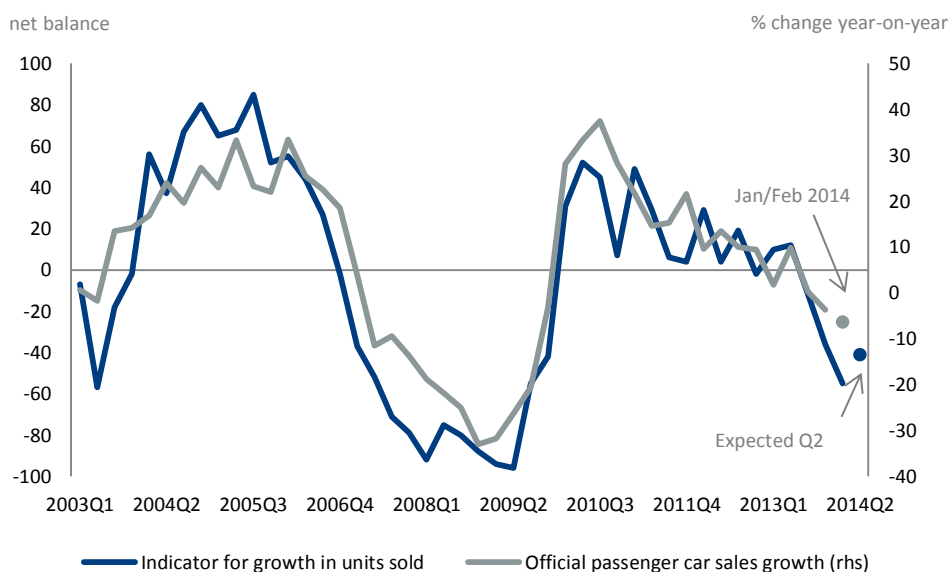
Figure 6: Retail trade sales volumes



Source: BER, Stats SA, SARB

As shown in Figure 6, official retail trade volumes as published by Statistics South Africa (Stats SA) roughly track the BER retail sales volume indicator. The current reading on the BER indicator remains consistent with a reading of around 3% on official retail volume growth during Q1. There is however some downside risks for both real retail trade sales and consumer spending data as published by the SARB. Should retailers' expectations materialise, this is especially the case for Q2.

Figure 7: Growth in passenger car sales



Sources: BER, the dti

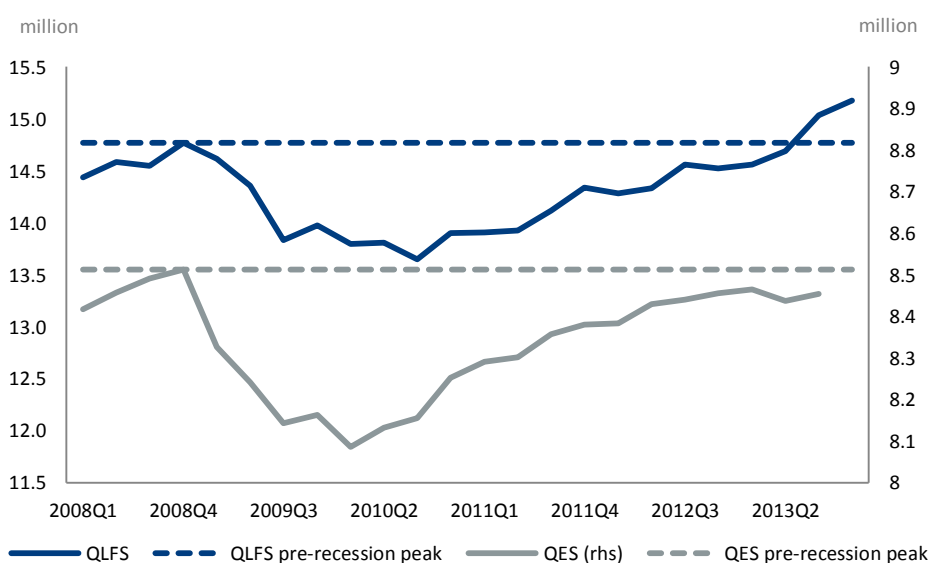
New vehicle purchases slowed notably towards the end of last year and into January/February 2014. Given that this is usually a leading indicator of consumer expenditure, it also highlights the downside risks. Figure 7 shows the BER motor trade indicator for growth in units sold against official statistics for growth in the number of local passenger car sales. Official passenger car sales contracted by 6.3% y-o-y during January and February, and are likely to register weak levels for Q1 and Q2 given the low level of the BER indicator.

Up to now, weaker consumer demand has been stemming mainly from the lower income groups. These consumers have been disproportionately affected by employment cuts, loss of income due to labour strikes, the faster increase in the price of basic commodities (such as food and petrol), high debt levels, tighter credit standards, as well as a notable slowdown in growth of government transfers to households. However, with the interest rate rising in January (opening the door for further increases during 2014), and real wage growth slowing notably, higher income consumers are also expected to come under pressure during the year. The contraction in new vehicle purchases might be foreshadowing a slowdown in spending by higher income consumers in particular.

Employment indicators deteriorate

There is currently a discrepancy between the two main official sources of employment data (both compiled by Stats SA), with the Quarterly Labour Force Survey (QLFS) notably more positive than the Quarterly Employment Survey (QES). See Figure 8. The latter tracks formal (non-agricultural) employment by surveying employers, while the QLFS surveys households on all labour market related activities (and includes formal as well as informal employment). According to the QLFS, all jobs lost during the 2008/9 recession have been recovered and employment growth averaged almost 4% y-o-y late 2013. On the other hand, the 2013Q3 (latest available release) QES estimates that formal employment is still more than 59 000 short of the pre-recession peak (reached in 2008Q2) while growth has waned to just 0.2% y-o-y.

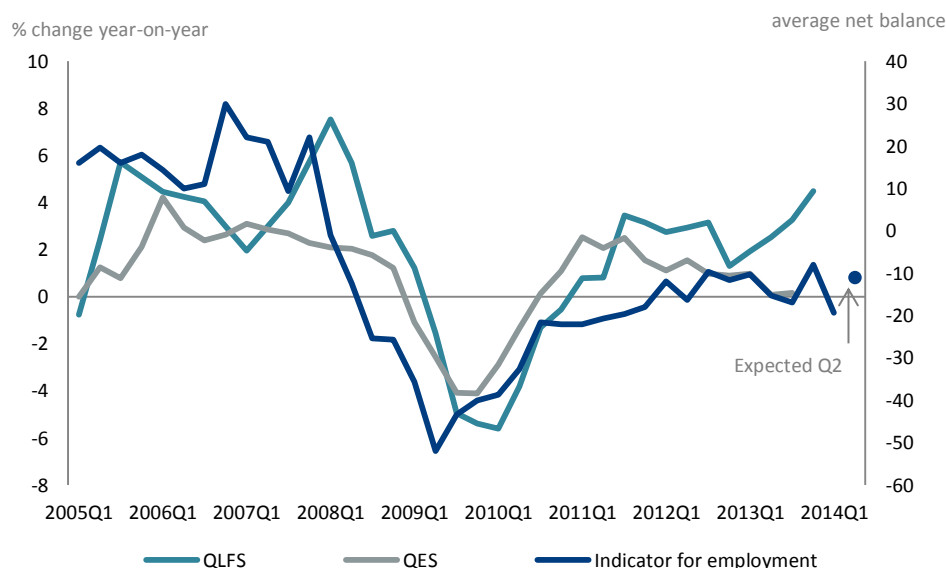
Figure 8: Official employment data



Source: Stats SA

The survey indicators for employment in all the major sectors deteriorated during Q1 after registering an improvement in 2013Q4. Figure 9 plots the average of these employment indicators across the building, manufacturing and retail sectors against growth in employment according to the QLFS and QES. The BER employment indicators have been more closely correlated with the QES growth rates during the post-recession period and imply muted growth in formal sector employment in early 2014.

Figure 9: Survey indicators point to weak employment growth early 2014



Sources: Stats SA, BER

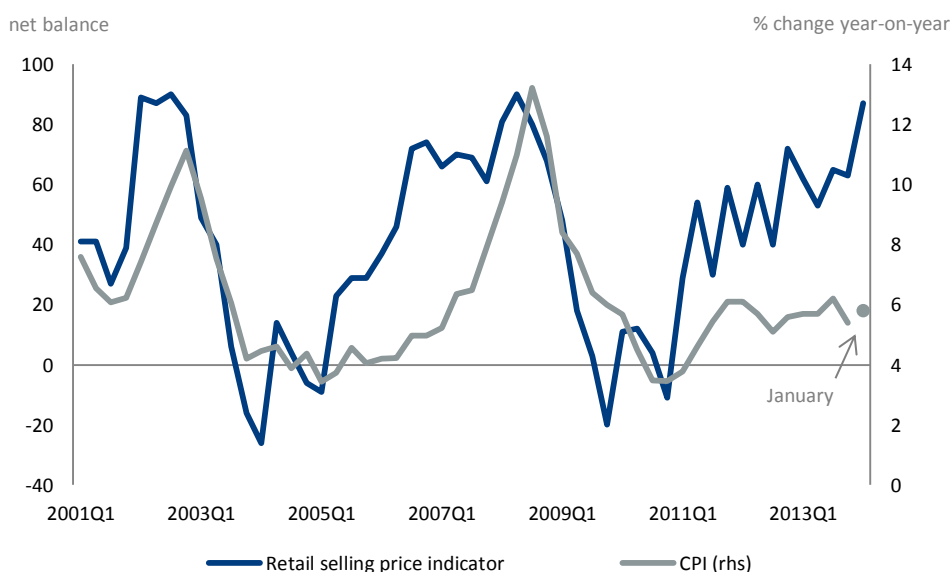
Costs and selling prices accelerate further

The survey results portrayed a very broad-based and consistent acceleration in purchasing as well as selling price inflation indicators. The only exception to an increase in cost and selling price pressures was that the rate of increase in the average total cost per unit of production in the manufacturing sector decelerated in Q1. This was the result of a noticeable deceleration in the rate of increase in the average per unit labour cost. The rate of increase in the average purchasing price of raw materials however rose significantly (in line with the Kagiso PMI™ price index which is currently at a record high).

Even as surveyed indicators of retail selling prices move significantly higher and anecdotal evidence of increased pass-through from the weak rand exchange rate mount, it is unclear by how much CPI inflation will react. As shown in Figure 10, the relationship between CPI inflation and the retail survey selling price inflation indicator has not been very strong since 2012.

There are important forces at play in the current economic environment which were not necessarily part of the landscape around 2002 and 2008 when CPI inflation did catch up to the rising trend in the retail survey selling price indicator. These include relatively low capacity utilisation and moderating unit labour cost increases, which are likely currently acting as significant countervailing forces to the inflationary process. Moreover, the survey results confirmed that both of these forces were probably prevalent (and perhaps even strengthened) in Q1.

Figure 10: The retail selling price indicator and CPI inflation



Sources: BER, Stats SA

The continued upward trend in the retail selling price inflation indicator does however highlight that the risk is surely that CPI inflation in Q1 and perhaps Q2 will be higher than expected. This information is consistent with the fact that the BER's forecast for CPI inflation in 2014 remains higher than at least the Reuters consensus forecast. There has also been a continued upward adjustment in both the Reuters and Beeld consensus forecasts for 2014 CPI inflation. These were adjusted from 5.6% (in December 2013) to 5.9% (in January 2014) and from 5.7% (in September 2013) to 6.1% (in February 2014) respectively.

Implications

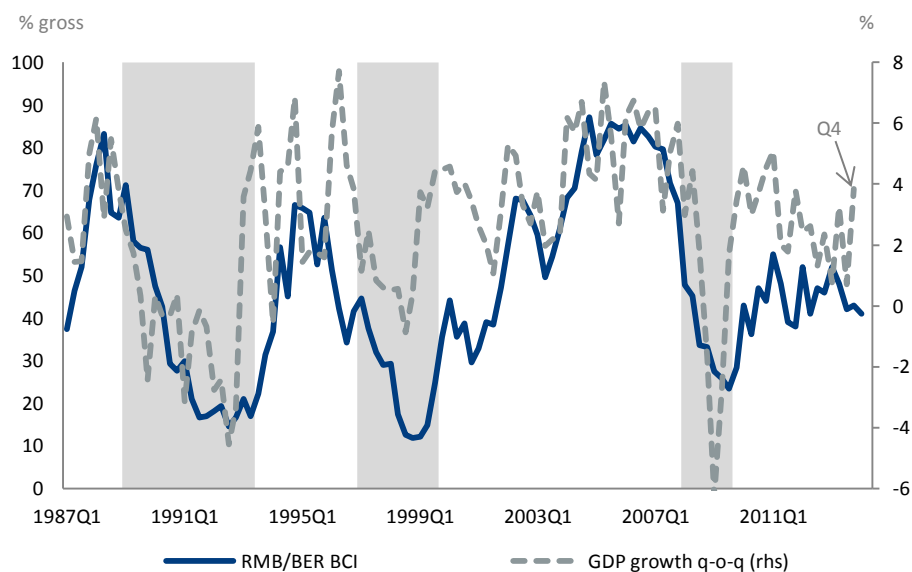
The slight retreat in the RMB/BER BCI, together with weaker growth in manufacturing production as well as wholesale, retail and new vehicle trade sales suggest that GDP growth is likely to lose some momentum in Q1. The fact that this coincided with other disruptions, such as the protracted strike in the platinum mining sector and periodic load shedding, implies that the BER's preliminary forecast is for the quarter-on-quarter (seasonally adjusted and annualised) GDP growth rate to slow to between 2% and 2.5%, from 3.8% in 2013Q4 – see Figure 11. On a y-o-y basis, GDP growth is likely to accelerate slightly.

However, the fact that there seems to be a rotation from consumption to investment and exports as sources of economic growth lays the foundation for more sustainable growth in the future. These trends, together with the assumption that the global economic recovery gains further traction, supports the BER's forecast for economic growth to accelerate to 2.6% this year, from 1.9% reached in 2013.

In all, the survey results mostly corroborate the direction of adjustments made to key macroeconomic forecasts during the BER's January forecasting round.⁶ These include an upward adjustment to the CPI and PPI inflation forecasts, a slight downward adjustment to the employment outlook and a downward adjustment to growth in consumption expenditure.

⁶ See **BER Economic Prospects 2014Q1**.

Figure 11: RMB/BER BCI as indicator of GDP growth momentum



Sources: BER, SARB

The survey information however provides slightly more positive (than expected) signals with respect to private non-residential fixed investment and manufacturing export volume growth. Table 1 summarises the implied risks to the BER's January forecast based on the recent round of surveys. These risks will be assessed when the BER forecast is updated early April.

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 to mild downside risk)				
	Gross Fixed Capital Formation (mild upside risk)				
	Exports (mild upside risk)				
	GDP: Gross Domestic Product (neutral)				
	Employment (mild downside risk)				
	CPI: Consumer inflation (mild risk for higher CPI inflation)				
	PPI: Producer inflation (risk for higher PPI inflation)				

Source: BER

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