

Comment

Activity picks up in some areas in 14Q3

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Introduction

A cornerstone of the BER's work is its regular business surveys¹. The aim of this note is to summarise some specific insights from the third quarter² BER surveys in the trade, manufacturing and building sectors, to be used as a first indication of likely developments in the real economy during 2014Q3 (until official data becomes 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.

Business confidence improves in the third quarter

The RMB/BER business confidence index (BCI)³ increased from 41 in the second quarter to 46 in the third quarter of 2014. This presents the first noticeable increase in the index since confidence fell from 48 to 42 in the third quarter of 2013 and hovered around this level for a year (see Table 1).

Table 1 RMB/BER Business Confidence Index (BCI) - % satisfied

	Building	Manufacturing	Retail	Wholesale	New vehicle trade	Total
13Q1	30	42	50	71	66	52
13Q2	45	34	41	61	61	48
13Q3	43	37	49	43	39	42
13Q4	47	36	40	51	41	43
14Q1	49	41	39	47	27	41
14Q2	45	25	49	44	43	41
14Q3	53	28	60	59	28	46

¹ 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.

² The third quarter survey was conducted among 2 300 firms between 4 August and 2 September 2014.

³ The BCI covers the building, manufacturing, retail, wholesale and new vehicle trade sectors and indicates the percentage of respondents that rated prevailing business conditions as satisfactory. It can vary between 0 and 100 and 50 is taken as the neutral level.

The rise in the RMB/BER BCI mirrors an increase in sentiment in all the sectors making up the headline index except for the new vehicle trade. Wholesale confidence increased by 15 points, retail by 11, building by 8 and manufacturing by 3, but motor trade confidence declined by 15.

Patchy recovery in activity

Although the end to the strikes will in itself lead to a big improvement in activity, the third quarter BER survey shows improvements in various other areas. However, the improvements are not widespread and modest. In most cases pre-strike levels of activity have not yet been matched.

After increasing from 39 to 49 in the second quarter retail confidence increased further to 60 in the third quarter. This is the highest level since the first quarter of 2012 and the first time in 2½ years that confidence is above the neutral level of 50.

Usually confidence and sales go hand in hand, but in the third quarter confidence rose while sales volumes did not improve universally across all categories. For instance, clothing and hardware sales rebounded after a poor second quarter, but food and furniture sales remained poor in the third quarter (see Table 2).

Table 2 Volume of retail sales – Stats SA vs. BER survey data

	Stats SA data		BER survey data			
	% change year-on-year		Net balance ¹			
	14Q1	14Q2	14Q1	14Q2	14Q3	14Q4 *
Total	3.1	1.5	-10	-8	-3	16
Semi-durables ²	8.7	2.2	-27	-39	53	59
Non-durables ³	1.3	1.6	-15	-8	-20	5
Durables ⁴	2.5	0.0	1	4	9	22

* Expected

1. The net balance statistic is the percentage of respondents replying "up" less the percentage replying "down". The percentage of respondents replying "the same" is ignored. The net balance can therefore vary between -100 and +100. It indicates the direction (up, same or down) and size (small or large) of the year-on-year percentage change of the corresponding quantitative data.

2. Clothing and footwear plus a proportion of the "other" category

3. General dealers, specialised food, pharmaceuticals and toiletries plus a proportion of other

4. Furniture, appliances, electronic equipment and hardware plus a proportion of other

The improvement in sales volumes boosted the profitability of clothing and hardware retailers. In the case of clothing retailers, a moderation in purchase prices provided additional support to profitability. In contrast, the profitability of food retailers took a knock, as price margins narrowed (due to the combination of soaring purchase prices and the curtailment of selling prices) on top of weaker sales volumes.

So, why did retail confidence rise so sharply in the third quarter? In the case of clothing and hardware retailers, underlying conditions improved and therefore supported confidence. However, it is surprising that such a relatively modest improvement led to such a big rise in confidence. In the case of food retailers, underlying conditions deteriorated and therefore did not support higher confidence. The only factor supporting food retailer confidence was their expectation that the situation would improve markedly in the fourth quarter.

The rise in retail confidence in general and the extent thereof in particular are not well supported by underlying conditions. This sector's recovery is therefore uncertain and confidence could retract if the expected improvement in conditions fails to materialise in the fourth quarter and beyond.

It is not unrealistic to expect conditions in the retail sector to improve going forward, but it could take longer than respondents expect and differ among retailers depending on whether lower or higher income earners are targeted. Rising wealth and lower inflation are bound to lift the willingness and ability of higher income households to spend even more at some time. However, rising interest rates could partly counter this. For total retail to improve, this will have to more than compensate for weak sales from lower income households, which will struggle due to the loss of income during the strikes, high debt servicing burdens, reduced access to in-store credit and unsecured bank loans, as well as rising unemployment.

Wholesale confidence jumped from 44 to 59, as sales of non-consumer goods (such as machinery, chemicals and building material) recovered after the labour strikes in the mining and manufacturing sector ended and the recovery in the residential building sector resumed. Retailers' increased orders of some categories also supported wholesale sales of consumer goods.

The confidence of building contractors increased from 45 to 53. This is the first time that building confidence has moved above the neutral level of 50 since the 2008 recession.

Whereas residential building activity put in a strong performance, non-residential activity faltered (see Figure 1). More lively real estate activity mirrors the improvement in residential building activity. Residential building activity could continue improving going forward if the imbalance between demand and supply continues and banks remain willing to extend new mortgage loans. In contrast, the weakness in non-residential activity is likely to continue for a while after a period of strong growth in retail and office activity. Furthermore, rentals are under pressure and vacancies high as supply ran ahead of demand in certain areas.

Civil construction activity dropped off unexpectedly in the third quarter (see Figure 2). This is partly due to the platinum strike, when the affected mines put all investment on hold. Now that the strike is over, it will take time for investment to resume. The other reason for the fall in activity could be delays in the awarding of new public infrastructure projects.

Figure 1 Building activity

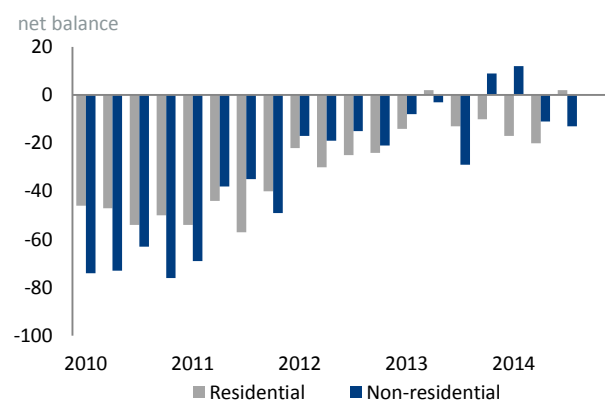
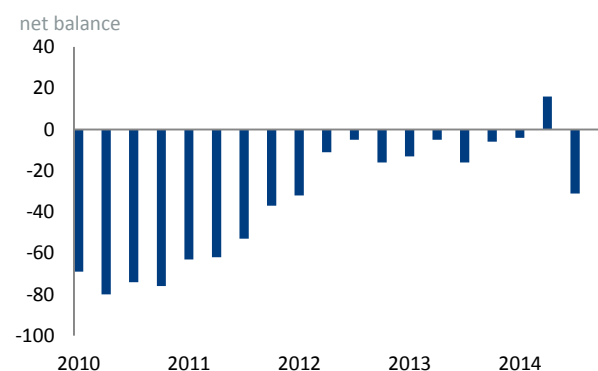


Figure 2 Civil construction activity



Manufacturing confidence increased marginally from 25 to 28, as sales and production recovered only partially from the second quarter's strike affected dismal performance (see Figure 3 and Figure 4). It will take more time before the sector recovers fully and the first quarter's higher growth rates are matched once more. For example, the strike in the platinum sector might be over, but manufacturers supplying into this sector will only see the real benefit of increased output when platinum miners return to full operation in the fourth quarter and beyond. Furthermore, the strike in the metals and engineering sector also only ended in July, which falls in the third quarter.

Figure 3 Manufacturing sales volumes

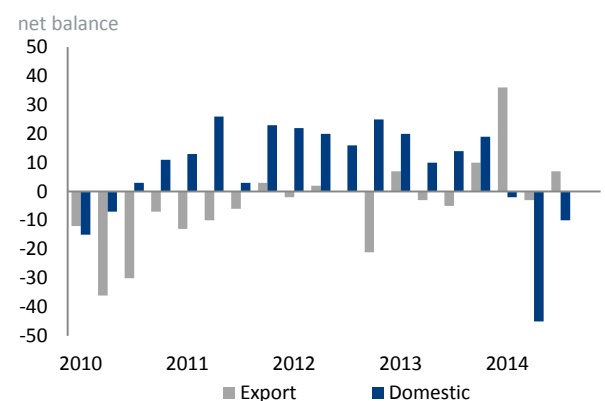


Figure 4 Manufacturing production volumes

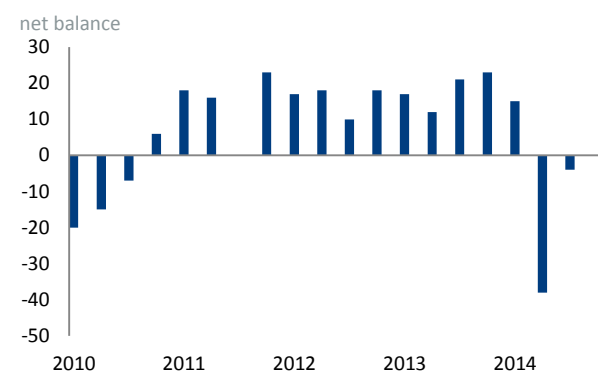
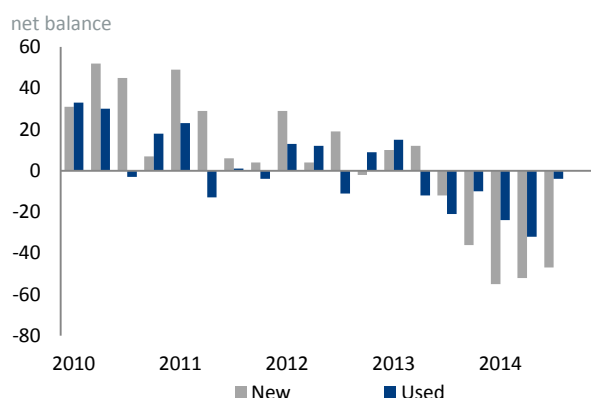


Figure 5 Vehicles: no. of units sold



Further declines in sales dampened new vehicle dealer confidence. At 28, business confidence reverted to the same low level as the first quarter. The second quarter jump to 43, therefore, turned out to be a temporary blip. In contrast to new vehicles, sales of used vehicles recovered impressively (see Figure 5).

Formal employment continued to decline

In the third quarter, employment in the manufacturing sector declined at an even faster rate (see Figure 6) and the improvement in employment in the building sector faltered (see Figure 7).

Figure 6 Manufacturing employment

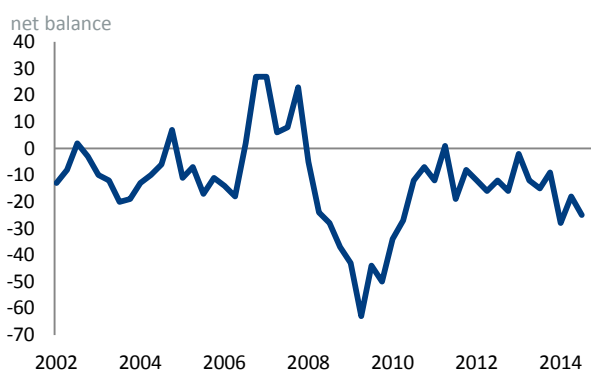
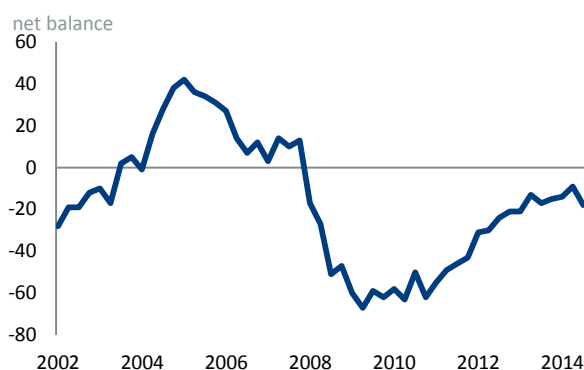


Figure 7 Building employment



Take note that the BER's panel of respondents consists of formal (tax registered) established businesses. It covers micro to large businesses, but not new and informal (non-tax registered) businesses. The BER's survey would, therefore, not record any changes in employment by new and informal businesses.

The BER's manufacturing survey provides some clues as to why manufacturing employment performed so poorly after the 2008 recession. In addition to weak demand, higher labour costs (see Figure 8) and the struggle to find skilled labour⁴ (see Figure 9) discouraged employment. Instead of hiring more workers,

⁴ The data series has a structural break in 1995. Before 1995 it had a cyclical pattern. After 1995 it shifted permanently upwards and did not decline to pre-1995 levels during the 2008 recession. The 1995 break in the data series coincide with the re-entrance of South Africa to the international economy. Given relatively high labour costs, firms are forced to upgrade machinery to remain competitive. To operate these sophisticated machinery the demand for skilled labour increased in turn.

firms continued to mechanise (see Figure 10) even though they have ample surplus production capacity (see Figure 11).

Figure 8 Manufacturing: labour costs per unit of production

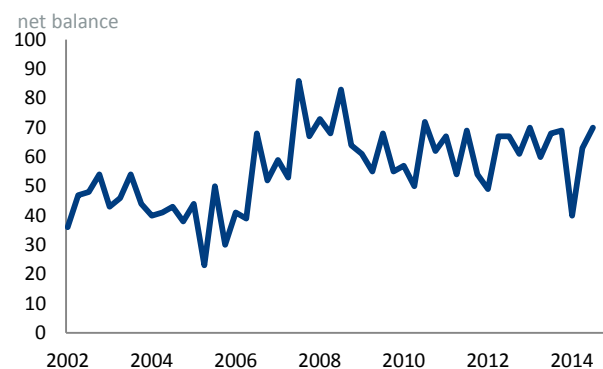


Figure 9 Manufacturing: skilled labour constraint

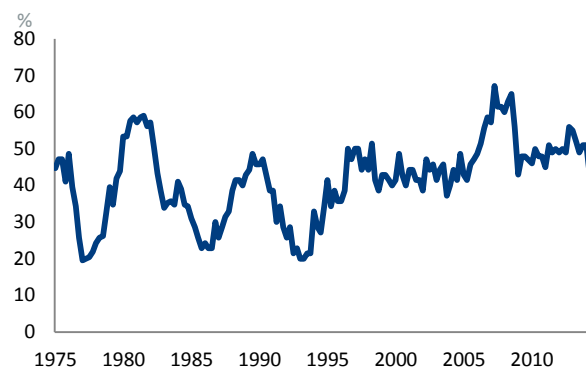


Figure 10 Manufacturing fixed investment

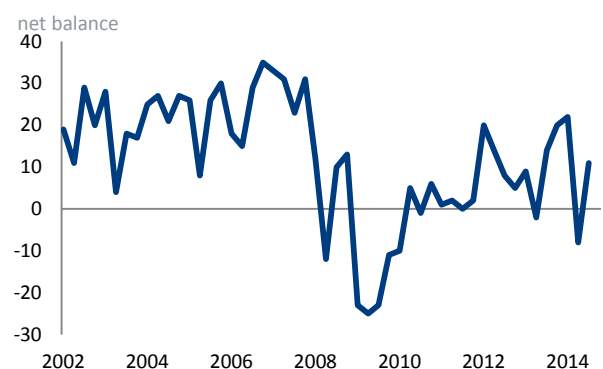
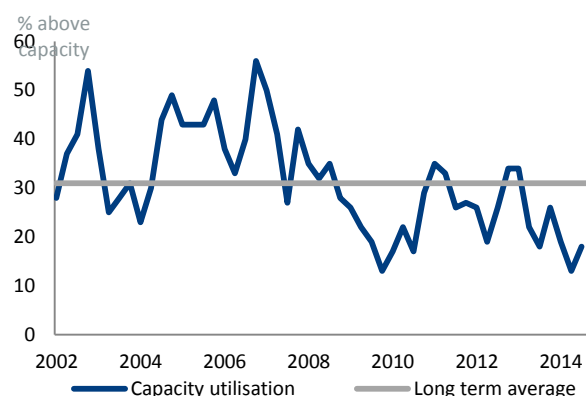


Figure 11 Manufacturing capacity utilisation



Rate of increase in selling prices has peaked

Respondents have experienced higher rates of increase in input costs since 2012. This higher increase coincided with the depreciation of the rand, as well as higher electricity and labour costs. The rate of increase in manufacturing and retail selling prices (see Figure 12 and Figure 13) accelerated until the first quarter of 2014, where after it moderated. This development supports the view that manufacturing PPI and CPI inflation are likely to moderate further in the near-term future.

Figure 12 Manufacturing: rate of increase in domestic selling prices

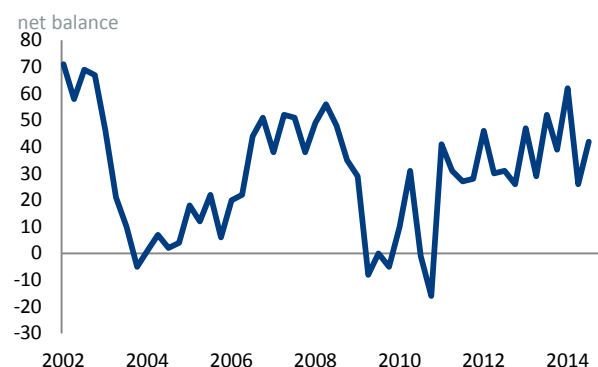
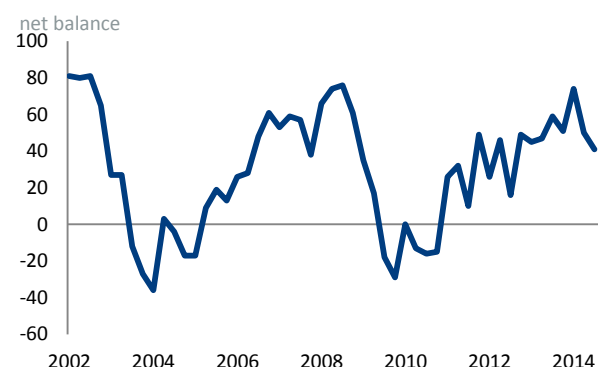


Figure 13 Retail trade: rate of increase in selling prices



Implications for the BER's macroeconomic forecast

The rise in the RMB/BER BCI indicates that economic growth will most likely recover further and that it will be stronger in the second half of the year than in the first half. This is in line with the BER's July forecast and we therefore do not have to adjust the forecast based on the 14Q3 BCI results alone. However, the month-long strike in the metals and engineering sector during July suggests that the second half recovery may be softer than previously expected. Stats SA reported that actual manufacturing production declined by 3.6% m-o-m in July. Combined with the weaker than initially thought 2014Q2 GDP growth figure, risks to our 2014 GDP growth forecast of 1.7% are on the downside.

The rise in retail and wholesale confidence was much bigger than one would expect given underlying developments. The BER forecast provides for a recovery in consumer spending in the second half of the year. Until the surveys show more significant improvements in underlying developments – particularly the growth in the volume of food sales and employment – there is no need to revise this forecast upwards based on the survey results alone.

Although we would not change our forecast of consumer spending, the survey results provide a valuable reminder that one should not merely project recent developments forward. The survey indicates not one, but several independent areas of renewed consumer activity, namely clothing and hardware retail sales, wholesale sales of consumer goods, used vehicle sales and residential building activity.

The moderation in manufacturing and retail selling price increases is consistent with the BER's forecast that CPI in all likelihood peaked in 2014Q2 and of lower CPI and PPI inflation in the next six months or so.

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