

BER Business Survey results signal a continuation of the Q2 growth soft-patch...

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Introduction – confidence declines further

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

This note aims to summarize some specific insights from cross-cutting trends observed in the third quarter round of BER surveys (conducted between 1 and 29 August) in order to provide a snapshot of the latest developments in the real economy. More detailed sectoral analyses will be provided in the respective BER survey publications.

The third quarter witnessed a further decline in business confidence as measured by the RMB/BER Business Confidence Index (BCI). The BCI declined by 9 index points (following a 7 index point drop in Q2) to 39 in 2011Q3. A reading of 39 indicates that 6 out of 10 respondents rated prevailing business conditions as unsatisfactory. Although signalled by the Kagiso Purchasing Managers' Index (PMI), perhaps the most distressing result is the noticeable decline in manufacturing business confidence – which halted the rebalancing of confidence away from the trade and towards the production sectors. Building contractors' confidence also remained in the doldrums. The wholesale and motor trade sectors again reported lower confidence levels, while business confidence remained relatively unchanged in the retail sector. Following the Q2 drop, the further decline in the RMB/BER BCI brings the strength of GDP growth in 2011Q3 into question.

Activity indicators

The BER manufacturing survey results indicated that manufacturing business confidence declined notably in the

third quarter. Manufacturing business conditions indicators mirrored the quarter-to-date (July and August) trends in the Kagiso PMI. Furthermore, it implies that the slowing trend in the rate of increase (year-on-year) in official manufacturing production data as published by Statistics South Africa could continue in the rest of Q3 (after the July drop of 6%) – as shown in Figure 1. Confidence declined on the back of lower than expected demand, albeit that some special factors (such as strike action and renewed uncertainty

with respect to the global economic recovery) might also have contributed to the decline in confidence. The index¹ of the percentage rating insufficient demand as a constraint on business activity increased sharply from 58 to 74 during Q3, the highest reading in a year.

Domestic demand sets the pace for manufacturing production. As shown in Figure 2, the indicators for domestic order volumes and manufacturing production track each other very closely. However, given that stocks of finished goods in relation to expected demand declined in the third quarter, a case can also be made that strike action and a furnace failure in the basic metal industry resulted in a larger knock to production volumes than implied by the demand softness only. Manufacturers expect demand and production to improve somewhat in the fourth quarter.

Figure 1: Manufacturing business confidence and production volume growth

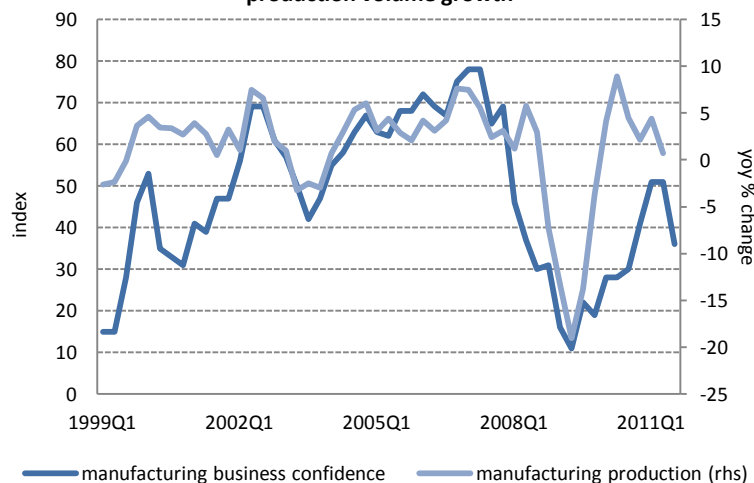
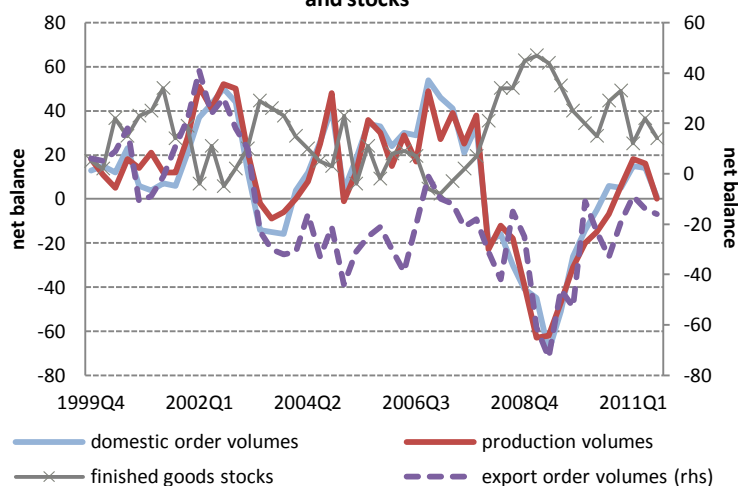


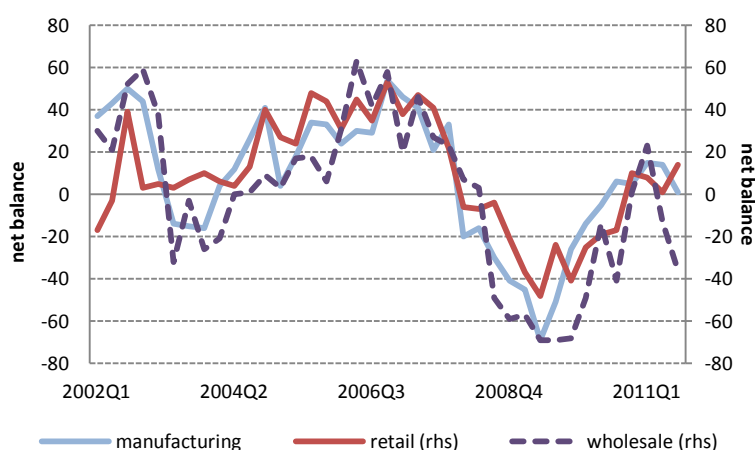
Figure 2: Manufacturing orders, production volumes and stocks



¹ Index is weighted as follows: 0,67 (% of respondents rating it to be a serious problem) + 0,33 (% of respondents rating it as slightly serious).

Wholesalers also reported a significant deceleration in sales volume growth, which largely explains the further drop in business confidence for the sector. Softer sales volumes forced a further deceleration in the growth of orders placed. Strike action in the transport industry during the quarter might have contributed to the deceleration in activity in the wholesale sector. On the other hand, retail demand seems to have improved during the

Figure 3: Manufacturing domestic order volumes; retail and wholesale growth in volume of orders placed



Source: BER

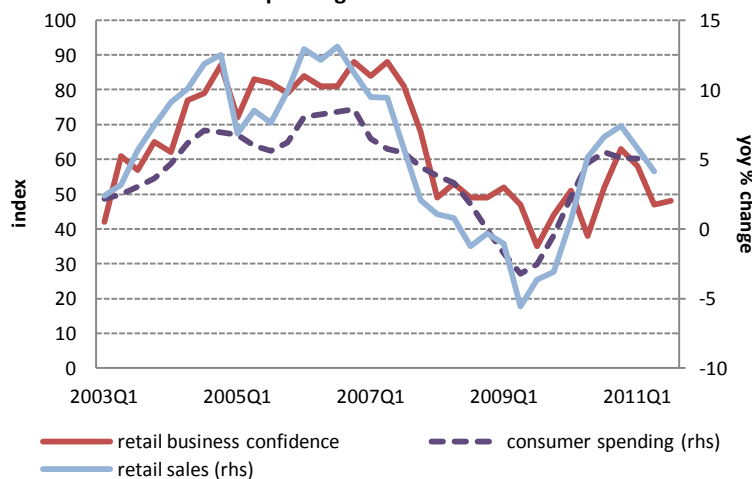
third quarter. Both the rates of growth in sales volumes and orders placed accelerated. Figure 3 plots the manufacturing domestic orders indicator against indicators for orders placed by retailers and wholesalers.

Although wholesaler order volumes are generally more volatile than those for retailers, the current disconnect hints that one may have to temper the positive interpretation of the Q3 bounce in retail sales and order volume growth. It is likely that the

large number of public holidays and base effects (due to the impact of the World Cup soccer tournament) had a particularly negative impact on sales volumes as reported in Q2. Although retail sales and order volume growth increased during the third quarter, the rise is far less significant when compared to the first quarter of 2011 and 2010Q4.

Another feature of the retail results which slightly taints the optimistic picture that is painted at first glance is the fact that the third quarter did not see a noticeable increase in retailer confidence after the sharp fall during Q2. Furthermore, retailers' rating of general business conditions deteriorated significantly. Retailers also seem to be cautious regarding the outlook for Q4, with particularly respondents in the non-durable goods sector expecting growth in sales volumes to decelerate. Figure 4 indicates that the current level

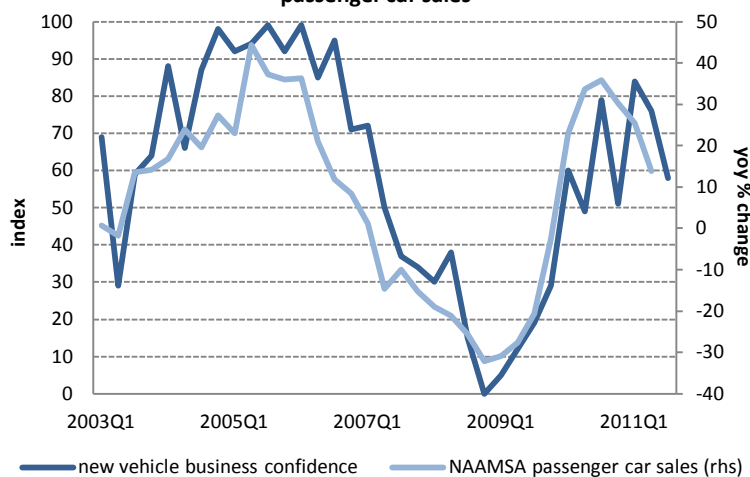
Figure 4: Retail business confidence and growth in consumer spending and retail sales



Source: BER; StatsSA

of retail business confidence points towards a further deceleration in the real growth (year-on-year) of official retail trade sales (after averaging 4.1% in 2011Q1, July volumes grew by 2.8%) and consumer expenditure.

Figure 5: New vehicle dealers' business confidence and passenger car sales



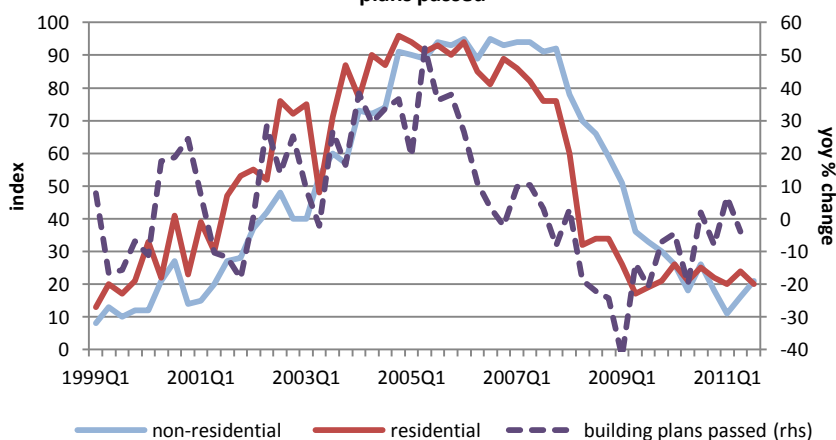
Source: BER; Naamsa

Growth in new vehicle sales continued to slide and resulted in a significant drop in new vehicle dealer confidence. The continuation of the deceleration in new vehicle sales after the Q2 softness – which could be attributed to specific factors (large amount of public holidays and supply disruptions as a result of the Japanese earthquake/tsunami) – suggests that more fundamental factors such as the maturity of the replacement cycle (and base effects), slower real income growth and lower confidence

levels (the FNB/BER Consumer Confidence Index declined from 11 to 4 points in 2011Q3) are at play. July and August passenger car sales as reported by Naamsa saw average volume growth of 8.8% (year-on-year), down from 25.6% and 13.7% during Q1 and Q2.

Furthermore, the third quarter also witnessed renewed softness in the residential building environment. The business confidence of residential building contractors declined on the back of further deterioration in building activity, while business confidence of non-residential contractors rose (see Figure 6). In all, the building and construction sector results disappointed in that the slight improvements reported during Q2 were mostly reversed in the third quarter. However, official building plans passed have recovered somewhat.

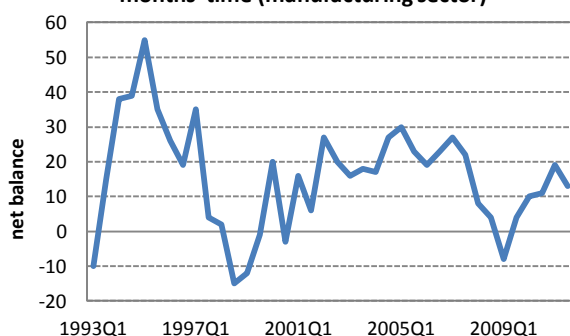
Figure 6: Business confidence of building contractors and building plans passed



Source: BER; StatsSA

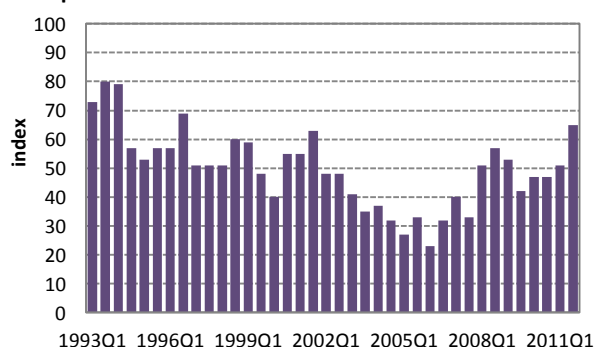
Apart from slower activity growth indicators, uncertainty rose significantly during the third quarter. Not only did the global economy witness severe market panic in August on the back of concerns regarding the fragility of the economic recovery, but local factors such as strikes (and some resultant tussles with trade unions) as well as increased talk about nationalisation are likely to have prompted a more cautious stance. Expectations regarding future business conditions have been negatively affected (as evident specifically in the manufacturing survey results as well as the Kagiso PMI). Moreover, this has translated in a downscaling of fixed investment plans. Manufacturing 12-month fixed investment expectations (as surveyed in the special focus on investment in every first and third quarter) dipped after a steady recovery – see Figure 7. The index of the percentage of manufacturers expecting the political climate to limit investment ability over the next 12 months rose notably and is currently at its highest level since 1996 (shown in Figure 8). Insufficient demand is also expected to limit manufacturers' ability to invest over this horizon.

Figure 7: Expected fixed investment in 12 months' time (manufacturing sector)



Source: BER

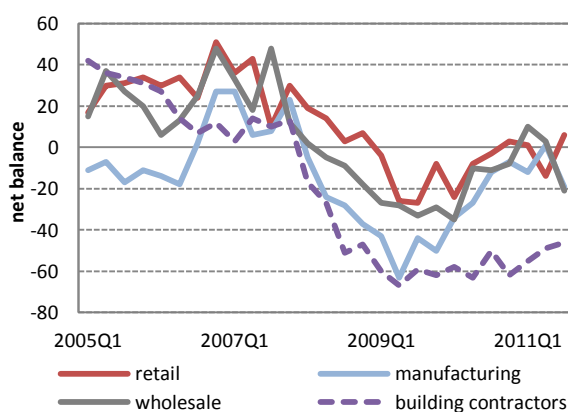
Figure 8: Weighted percentage rating general political climate a constraint on fixed investment



Source: BER

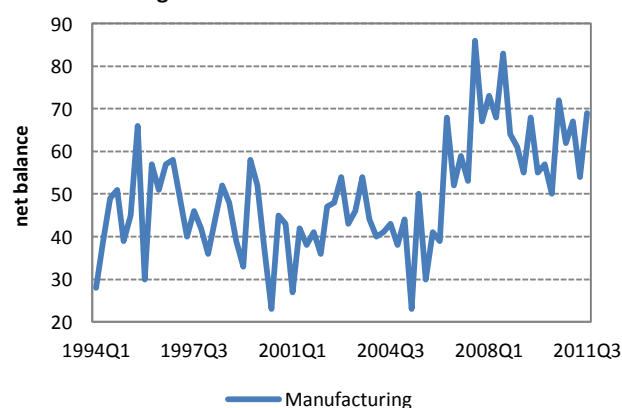
Employment

Figure 9: Employment indicators



Source: BER

Figure 10: Unit labour cost inflation



Source: BER

Activity improvements earlier in the year failed to translate into sustained employment growth. In fact, currently employment growth is highly fickle with only the retail sector reporting growth in the number of people employed (as shown in Figure 9). Although the employment indicator for the wholesale sector was in positive territory during the first half of 2011, it declined noticeably in the third quarter. There was also renewed weakness in the level of manufacturing sector employment, with respondents again reporting a decline in the number of factory workers employed (after a slight recovery in 2011Q2). Building sector employment remains in the doldrums.

The fact that per unit labour cost inflation remained relatively high can to some extent explain the weak employment situation. Figure 10 depicts the indicator for the rate of increase in average labour cost per unit for the manufacturing sector and shows the re-acceleration in per unit labour cost inflation after the recession saw only a limited slowdown. Manufacturers expect the number of factory workers to decline further in the fourth quarter.

Prices and profitability

Manufacturers have reported a deceleration in total unit cost inflation and the PMI price index echoes this slight respite in input costs. Furthermore, manufacturers' domestic selling price inflation slowed further during Q3, following a deceleration in Q2 after the sharp acceleration in the first quarter. Both these bode well for producer price inflation as measured by the PPI – see Figure 11.

A deceleration in both purchasing and selling price inflation was also reported at the retail level (Figure 12), implying that the risk that the inflation outlook will surprise on the upside (higher than expected) has diminished somewhat during Q3. However, if recent rand weakness continues, this is no longer necessarily the case.

Figure 11: Manufacturing input cost and selling price inflation

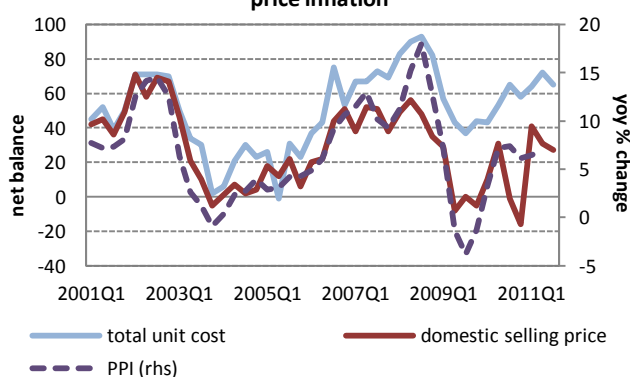
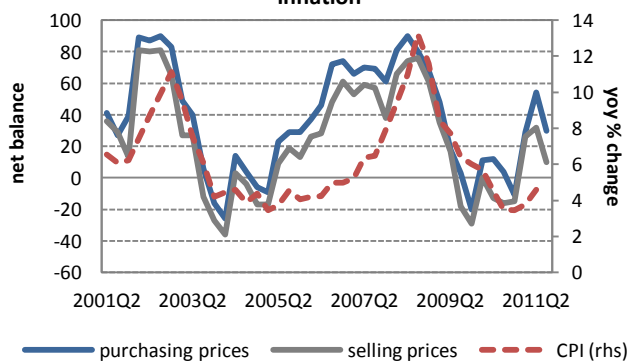
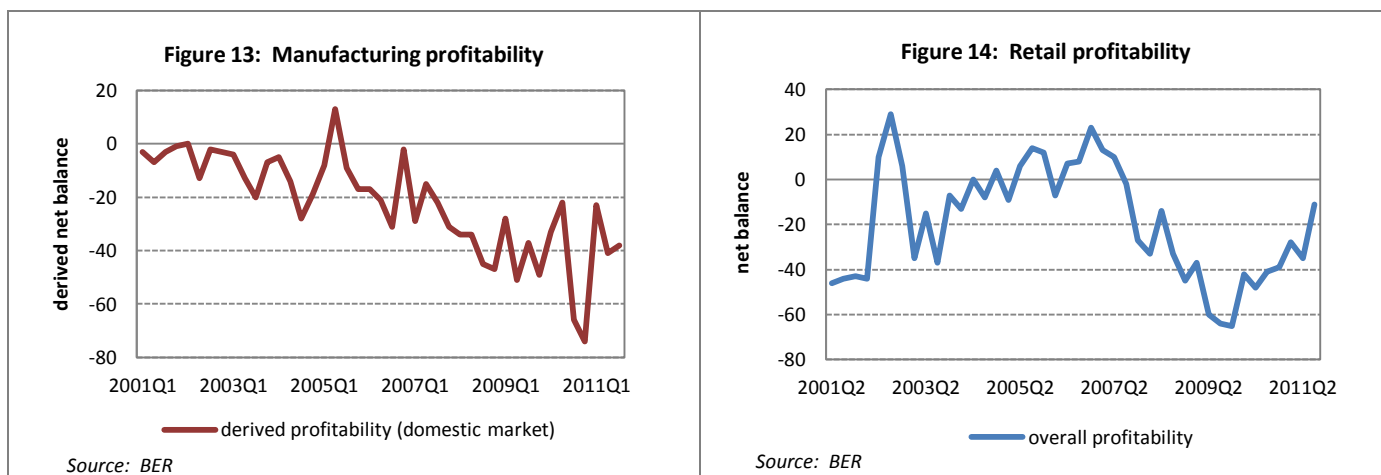


Figure 12: Retail purchasing and selling price inflation



The third quarter saw a slight improvement in profitability in the manufacturing sector – but as illustrated in Figure 13, the sector remains fragile from a profitability perspective. Overall profitability in the retail sector has improved noticeably in the third quarter (as shown in Figure 14).



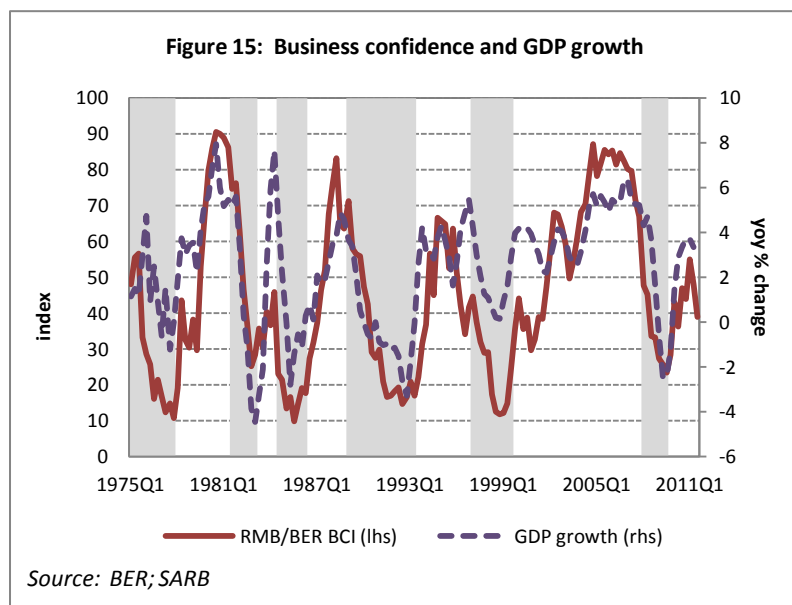
Concluding remarks and implications

On balance, the 2011Q3 survey results sensitises one to the possibility that growth in underlying demand might be running out of steam faster than anticipated. The fact that the recovery has not been accompanied by meaningful employment creation (but rather high real wage growth) or credit extension brings the momentum of growth into question.

Furthermore, indicators on total unit cost, purchasing price and selling price inflation all indicate that the risk that the inflation outlook could surprise on the upside (higher than expected) has diminished somewhat during Q3. However, if recent rand weakness continues, this is no longer necessarily the case.

Another key trend of the results is that uncertainty has increased notably in Q3. August witnessed market panic over the fragility of the global economic recovery. This coincided with an increase in the domestic political risk factor. Not only has this impacted negatively on firms' current and planned fixed investment, but it might also hamper employment creation in the face of high real wage growth and doubt regarding the strength of demand growth. Moreover, uncertainty with respect to the continuation of the global economic recovery increased notably in the past few weeks (after the compilation of the survey results).

Figure 15 shows the strong correlation between the RMB/BER BCI and year-on-year GDP growth. The results signal that the Q2 soft-patch in GDP growth is likely to have continued in the third quarter. A more downbeat



interpretation of the further decline in the business confidence index (bringing the combined second and third quarter drop to 16 points) would be that it brings the sustainability of the upswing into question. The fourth quarter survey results will be crucial insofar as it provides justification for such an interpretation or not. At this stage our reading of the results is that it only signals a continuation of the Q2 growth soft-patch and that we will continue to muddle through until something provides the economic recovery with the necessary second wind.

However, the downside risks to our economic growth outlook have recently increased given the downgrading of growth prospects for the major developed economies. One is reminded that the road from trough to peak is more often than not a bumpy one.

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