

Comment

Business confidence and activity improved further in the fourth quarter

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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 fourth 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 the fourth quarter (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 increased further

The RMB/BER business confidence index (BCI)³ increased from 46 in the third quarter to 51 in the fourth quarter of 2014.

A reading of 51 indicates that about half of the respondents were satisfied with prevailing business conditions in the fourth quarter. After close to two years of business confidence in net negative territory, the fourth quarter of 2014 presents the first time since the first quarter of 2013 that confidence is back at a neutral level.

The rise in the overall confidence index stemmed from big increases in building and manufacturing confidence, which more than compensated for a decline (albeit from a high level) in retail confidence.

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 fourth quarter survey was conducted among 2 900 firms between 27 October and 20 November 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.

Wholesale confidence remained almost unchanged at a high level and motor trade was stable at a low level.

Activity continued to recover

A hefty 13 point jump (from 53 in the third quarter to 66 in the fourth quarter) lifted building confidence to its highest level since the 2008 recession. Although confidence rose across the board, residential building activity accelerated noticeably, while non-residential building activity contracted even faster (see Figure 1).

Figure 1 Building activity

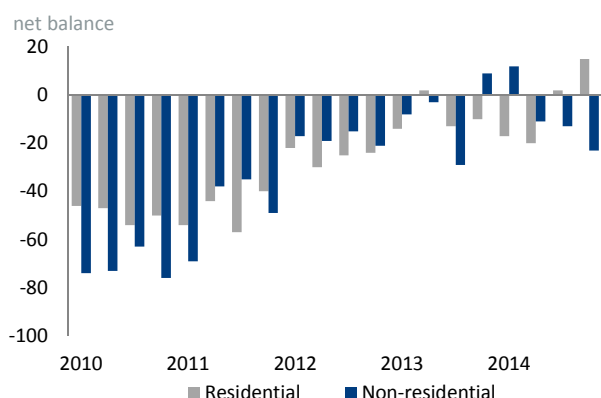
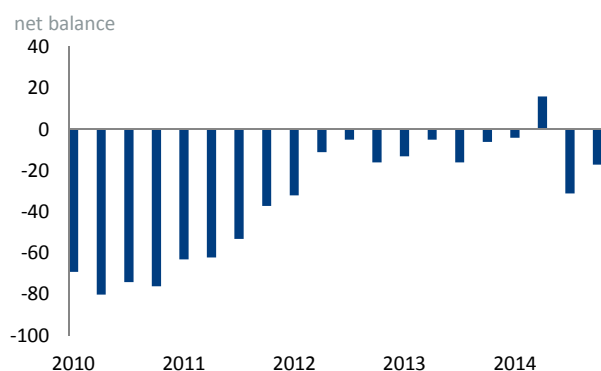


Figure 2 Civil construction activity



Source: BER

Both residential and non-residential builders assess the fourth quarter development to be temporary and expect the situation to reverse in the first quarter. While residential builders expect activity to contract in the first quarter, non-residential builders anticipate a recovery. Our assessment differs from those of the respondents. In our view, the recovery in residential building activity is likely to be sustained in the near term future, because there is bound to be pent-up demand after residential building activity remained weak in the six years since the financial crisis. Furthermore, activity in the secondary (real estate) market is on the mend and some banks have eased credit standards on mortgages. In contrast, we expect non-residential activity to remain soft for a while, as the growth in the supply of shopping centres and office blocks, for instance, exceeded economic growth over the last year or so. However, both architects and quantity surveyors saw better activity in the fourth quarter compared to the third quarter, which foreshadows better non-residential activity going forward if these plans materialise.

Civil construction activity hit a soft spot in the second half of the year (see Figure 2).

After reaching lows of 25 and 28 in the second and third quarter respectively, manufacturing confidence bounced back to 42 in the fourth quarter as the adverse impact of the labour strikes dissipated. Sales recovered (see Figure 3) and profitability improved, as cost increases moderated.

Figure 3 Manufacturing sales

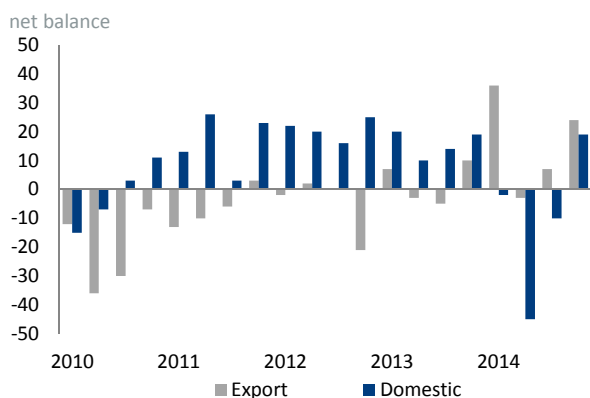
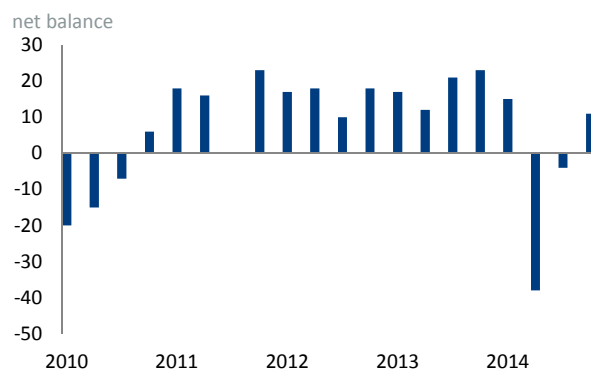


Figure 4 Manufacturing production



Source: BER

According to the BER's fourth quarter manufacturing survey, current stocks relative to expected demand declined sharply, as sales expanded at a noticeably faster pace than production (see Figure 4). The implications of these developments for production growth going forward could be twofold. Firstly, manufacturers will have to scale up production further in the near term future to satisfy demand, as supply cannot continue out of existing stocks. Secondly (and also the one that the respondents foresee), the fourth quarter upsurge in sales was temporary (probably due to the delayed impact of the labour strikes) and will therefore likely subside with the result that production will not need to be stepped up further in the first quarter. Production growth will therefore either accelerate or remain stable at a modest pace depending on whether the fourth quarter vibrant sales continue or not in the first quarter and beyond.

Having jumped from 49 to 60 in the third quarter without a corresponding improvement in sales and profitability, retail confidence was bound to correct in the fourth quarter. Retail confidence declined from 60 to a still decent 55. With the exception of clothing, sales picked up. Furthermore, it seems that this improvement was not only due to the normal increase in the run-up to Christmas, but there were also some gains from cash sales and higher income consumers.

Sustained (albeit low) sales growth kept wholesale confidence unchanged at a high level (it moved from 59 to 60). In contrast, continued weak sales kept new motor dealer confidence at a depressed level (it moved from 28 to 30).

Price increases moderated

Before the sharp decline in the international oil price, many analysts were worried that the sharp depreciation of the rand and high wage increases over the last two years would push inflation higher when demand recovers and producers and retailers are in a good position to hike their selling prices to compensate for these higher input costs, the so-called second round effect.

The latest survey results show that both manufacturers and retailers further tempered the rate of increase in selling prices (see Figure 5 and Figure 6).

Figure 5 Manufacturing domestic selling prices

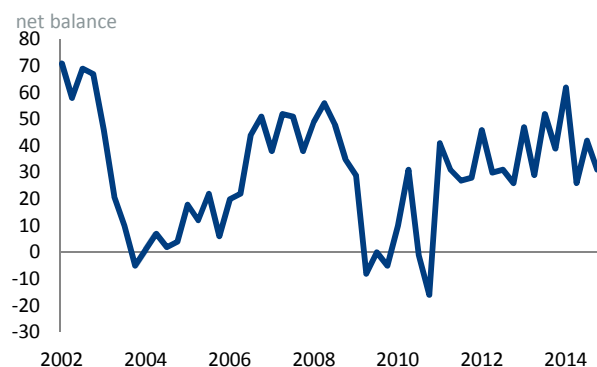
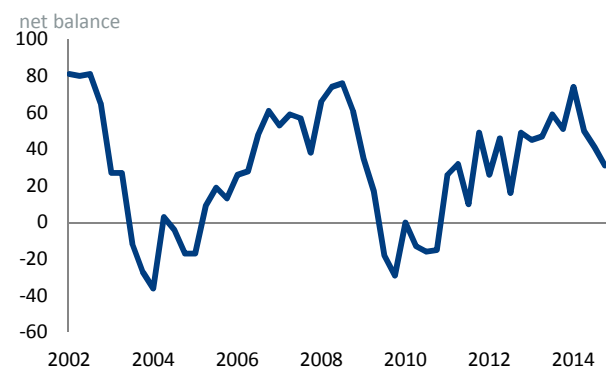


Figure 6 Retail selling prices



Source: BER

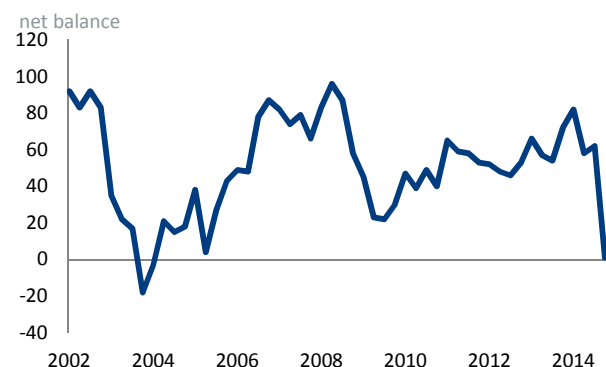
This moderation in the rate of increase in selling prices comes to a large extent from an unusually sharp fall in the rate of increase in the average total cost per unit of production (see Figure 7). This is the biggest fall ever recorded since the BER started covering the increase in production costs in 1988. To put the fourth quarter fall in perspective: the second biggest decline occurred in the fourth quarter of 1995 and then the size was half of that recorded in the current quarter⁴.

The sharp slowdown in production costs partly stems from an equally sharp deceleration in raw material price increases (see Figure 8). This, in turn, comes from the decline in the international price of oil and many other raw materials.

Figure 7 Manufacturing total production costs



Figure 8 Manufacturing raw material purchase prices



Source: BER

⁴ A closer inspection of the results show that in the third quarter a weighted 77% of respondents replied that the rate of increase in the average total cost per unit of production was "up" compared to the third quarter of 2013, 22% that it "remained the same" and 1% that it was "down". The respective figures for the fourth quarter were 42% "up", 29% "the same" and 29% "down". So, many respondent that replied "up" in the third quarter, shifted their opinion to "the same" or "down" in the fourth quarter. To be sure, the fourth quarter results indicate a moderation and not a contraction in the rate of increase in production costs.

Manufacturing respondents also reported a sharp deceleration in the rate of increase in average labour costs per unit of production. This is surprising given that manufacturers did not reduce employment at a faster rate and after the labour strike higher wage rates became effective.

In all, the extent of the slowdown in the total average cost per unit of production is larger than one would expect, especially considering higher wage and electricity costs. If this result is confirmed next quarter, one would have more confidence that cost increases slowed down to such an extent.

Despite this qualification, it would be fair to conclude that the average cost per unit of production is moderating and that this has fed through to lower increases in selling prices and thus goods inflation. Although activity is on the mend, it appears that many producers and retailers continue to not fully pass on earlier cost increases in the form of higher selling prices.

Implications for the BER's macroeconomic forecast

The rise in the RMB/BER BCI is consistent with forecasts of stronger GDP growth in the fourth quarter. The recovery in manufacturing production, rising residential building activity, and sustained, but modest retail and wholesale sales growth would all ensure real GDP growth accelerates noticeably from the 1.4% annualised rate of the third quarter. Although not captured in our surveys, an expected normalisation in mining output should also boost Q4 GDP growth.

Closing the year on a stronger foundation is a good starting point for next year. In the absence of another turbulent year in the labour market and sustained Eskom load shedding, the economy looks good for growth of around 2.5% in 2015 - not a great outcome but nonetheless an improvement on this year.

The moderation in manufacturing and retail selling prices also supports the BER's forecast of PPI inflation slowing from 7.6% in the first quarter of 2014 to about 5.5% in the first quarter of 2015 and CPI inflation from 5.9% to about 5.1% over the same time period.

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