

Comment

BER surveys show a worsening of the domestic trading environment in Q3

Confidence

Activity

Employment

Costs and prices

Implications

Introduction

A cornerstone of the BER's work is its regular business surveys¹. The results of the latest round² of BER surveys in the trade, manufacturing and building industries are summarised below.

The results suggest that domestic demand surprised on the downside in 2015Q3, particularly in the retail trade sector. Business conditions remained lacklustre and rising costs increased pressure on profitability. Business confidence registered its third consecutive drop and there is also other evidence of increased uncertainty. These factors impacted negatively on fixed investment outlays and do not bode well for a recovery in private sector formal employment.

The surveys serve as a first indication of likely developments in the real economy during the third 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 website.**

Business confidence registers third consecutive drop

The RMB/BER Business Confidence Index (BCI)³ dropped to 38 during 2015Q3, its lowest level since 2011Q4. The RMB/BER BCI has been on a downward trajectory this year. The largest contribution to the decline in overall business confidence came from the retail trade sector, where confidence fell 18 index points (from 52 to 38).

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. More information is available on the BER website.

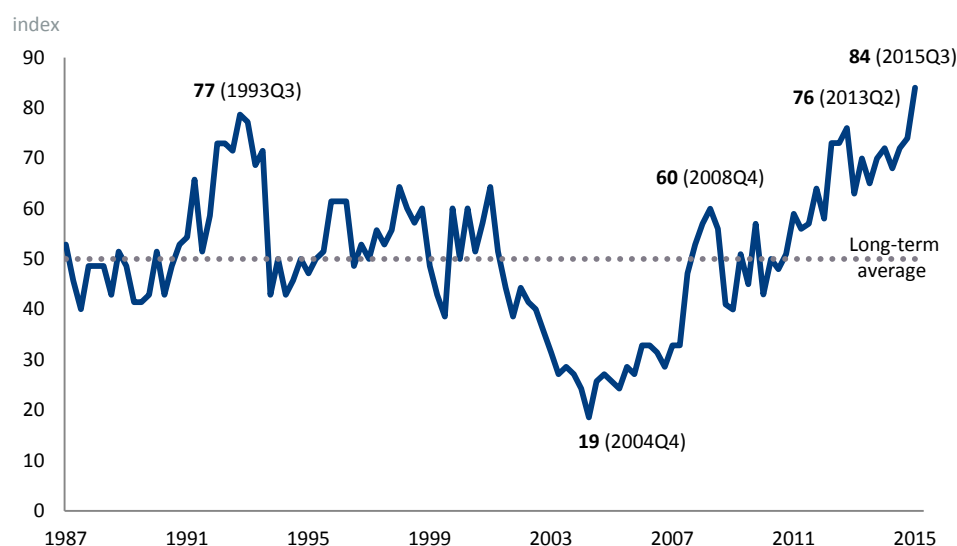
² The survey was conducted between 27 July and 1 September.

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 retail sector results registered the sharpest deterioration in business conditions, but across the different surveys there are indications of a worsening of the domestic trading environment during the third quarter. These include renewed pressure on profitability in both the retail and manufacturing sectors, while profitability continued to disappoint in the building industry.

Furthermore, the rating of insufficient demand as a serious constraint on business activity remained at high levels in both the building and manufacturing sectors. Worryingly, this quarter also witnessed a notable jump in the rating of the general political climate as a serious constraint on business activity in the manufacturing sector. As shown in Figure 1 below, this index rose to its highest level on record in Q3. While this indicator can be quite volatile, the relatively high levels recorded and the upward trajectory since late 2011 is disconcerting.

Figure 1: Rating of the general political climate as a serious constraint on manufacturing business activity



Source: BER

In interpreting this index, it should be noted that the meaning of 'political climate' is not defined to survey respondents and is thus open to interpretation. Hence, respondents may include concerns about for example disruptions caused by load-shedding or strike action. In general, the rating of the political climate is inversely related to the overall RMB/BER BCI and increases can be interpreted as a sign of increased uncertainty.

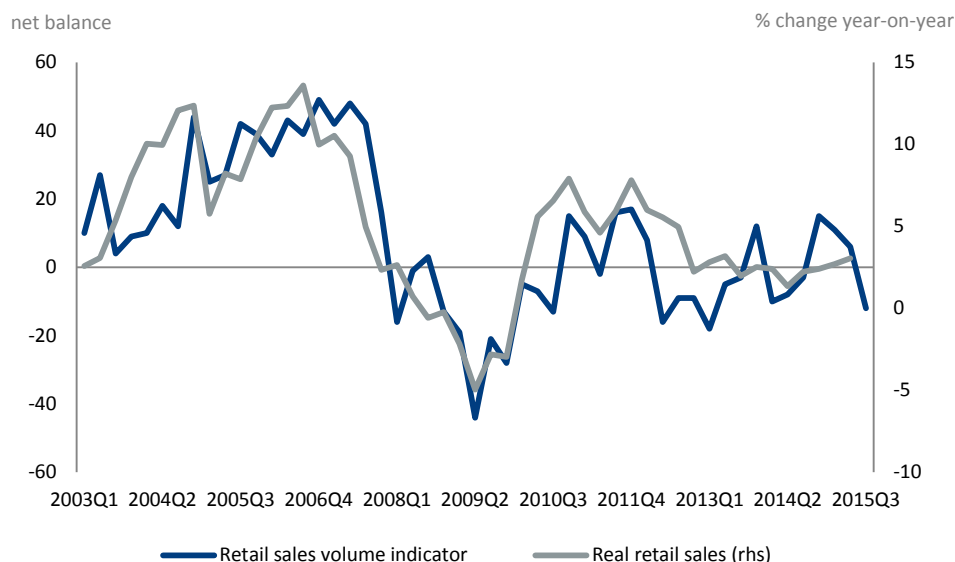
Sharp adjustment in retail trade activity and investment plans

The **retail** trade survey results pointed to a sudden and broad-based weakening of domestic demand in Q3. The indicators for growth in the volume of sales deteriorated significantly across all the retail subsectors. While weakness in consumer spending was foreshadowed by the plunge in the FNB/BER Consumer Confidence Index (CCI) to a 14½-year low of -15 during Q2⁴, the adjustment in retail trade activity was sharper than expected. The reading on the retail sales volume indicator implies that official

⁴ To download the FNB/BER CCI report, [click here](#).

retail trade sales growth, as published by Stats SA, could slow noticeably on a year-on-year (y-o-y) basis in Q3 – see Figure 2.

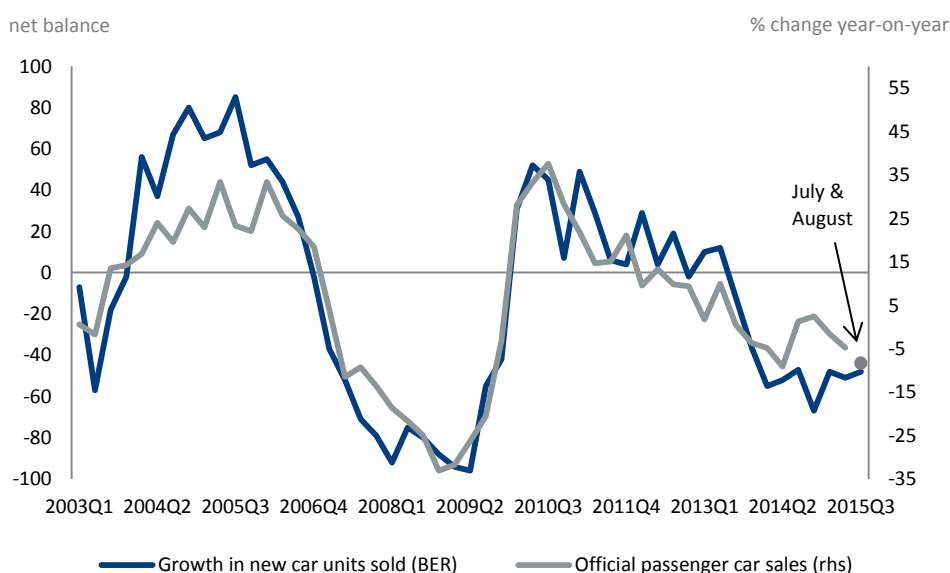
Figure 2: Retail sales volume indicator versus official retail sales volume growth



Source: BER, Stats SA

In line with official data on new passenger car sales, growth in units sold as reported by the **motor trade** sector remained in negative territory (Figure 3). Moreover, the picture might in fact be even worse than portrayed by the sales indicator as the current level of stocks in relation to expected demand is at its long-term maximum level.

Figure 3: Growth in new car units sold versus official passenger car sales

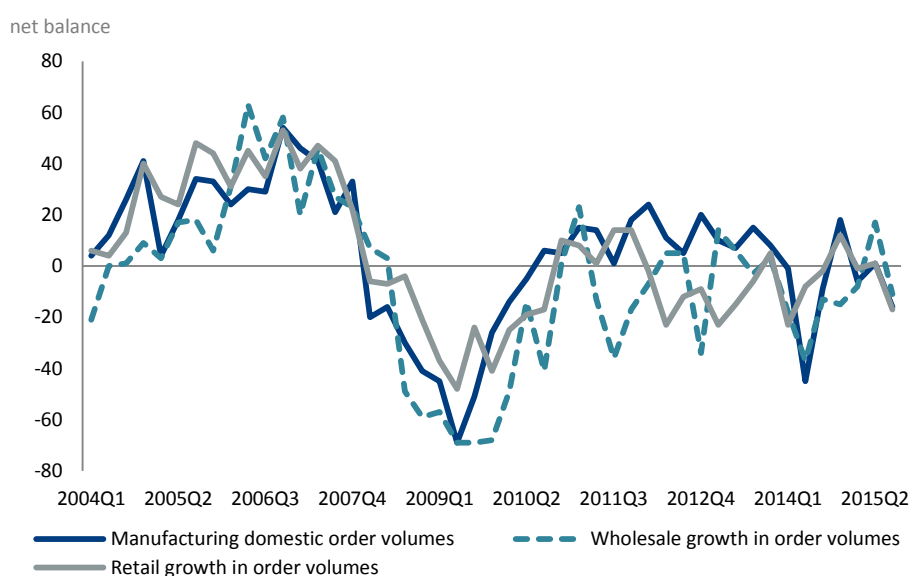


Source: BER, dti

The **wholesale** sector also reported a deterioration in the growth of sales volumes. Although this was the case for wholesalers in both the non-consumer and consumer markets, the deterioration was somewhat less pronounced for consumer goods. It might be that import-substitution, given the weaker rand exchange rate, is providing some support to these wholesalers.

The weakness in domestic demand was echoed in the **manufacturing** sector, where the domestic sales and order volume indicators are in negative territory. As is the case in the wholesale sector, certain consumer goods subsectors (for example the beverages, clothing and to some extent food industries) are also outperforming at the manufacturing level. Figure 4 shows the synchronised decline in the order volume indicators across the manufacturing, wholesale and retail sector surveys during Q3.

Figure 4: Order volume survey indicators across the manufacturing, wholesale and retail sectors

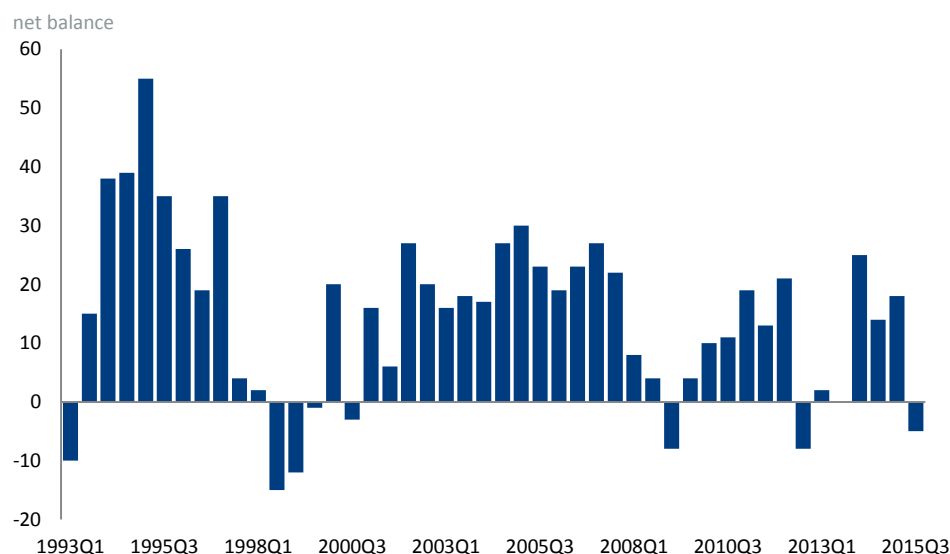


Source: BER

Indicators for export sales and order volumes returned to positive territory in Q3. The manufacturing production indicator points to rather flat production volumes on a year-on-year basis. Furthermore, the average of the business activity index of the Barclays PMI for the first two months of Q3 came in at 50.9, up from an average of 47.3 recorded in Q2. Hence, official manufacturing output as reported by Stats SA may improve slightly in Q3 after the sector's 6.3% quarter-on-quarter (q-o-q) contraction in Q2. However, it remains uncertain how the continued woes in the steel sector could affect actual activity growth.

One of the key results of the manufacturing survey was a consistent downscaling of current and planned investment outlays. Apart from the fact that slack capacity in the economy is forcing a delay in fixed investment outlays, increased uncertainty and low business confidence are likely also showing up in renewed caution on this front. Most manufacturing fixed investment indicators dipped well below long-term average levels in Q3. Especially medium-term investment plans were scaled back significantly. Figure 5 illustrates this by showing that negative readings on the indicator for total manufacturing fixed investment plans over the next 12 months are rare. The current reading compares to episodes of recession (1992/1993, 1998 and 2008/2009), and to the 2012/2013 period which was also characterised by high levels of uncertainty.

Figure 5: Expected total fixed investment over the next 12 months in the manufacturing sector

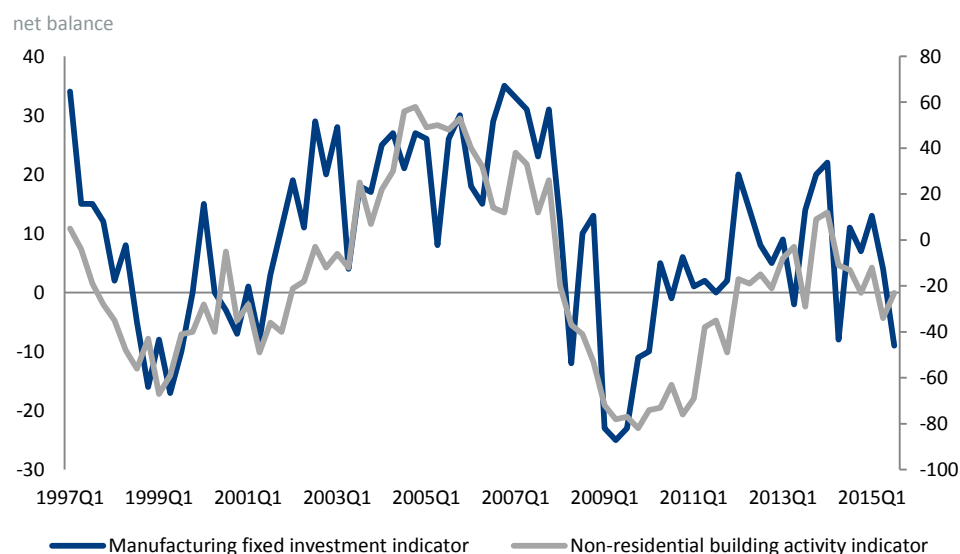


Source: BER

These results corroborate the recent (August) sharp contraction in actual domestic commercial vehicle sales. So far, third quarter sales are down 5.7% y-o-y from a decline of 1.8% during Q2. Sales of commercial vehicles were still growing at 3% in the first quarter.

Building sector activity did not weaken further during Q3, following the retreat in the second quarter. There was, however, a noticeable deterioration of the non-residential building sector pipeline, with both architects and quantity surveyors reporting sharp decelerations in the growth of commissions at working drawing stage in Q3. This deterioration of the pipeline is in line with the sharp adjustments to fixed investment indicators in the manufacturing sector. As shown in Figure 6, non-residential building activity tracks the manufacturing fixed investment indicator fairly well over the long term. Given this relationship, it is difficult to expect sustained improvements in non-residential building sector activity.

Figure 6: Investment indicators across the manufacturing and building sectors

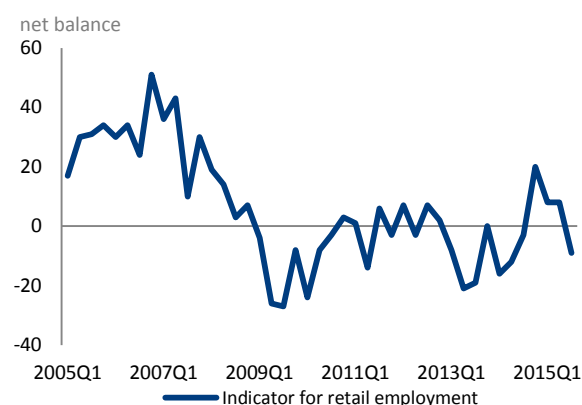


Source: BER

Employment indicator dipped

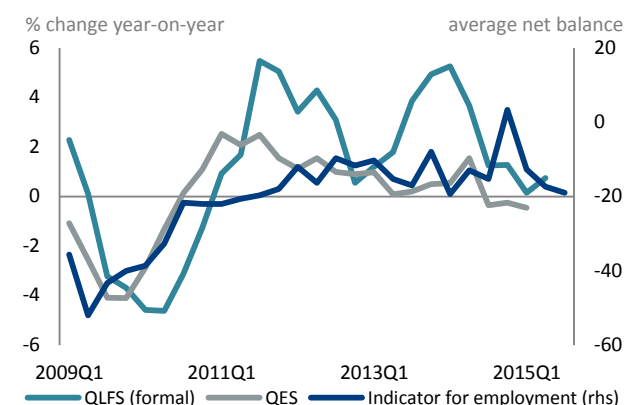
The average employment indicator across the retail, manufacturing and building (contractors) sector surveys dipped in Q3. The decline was on the back of a contraction in the growth in the number of people employed in the retail sector (Figure 7). Trade has been one of the few sectors contributing to employment growth in the formal sector this year. If sustained, it will necessitate a notable downscaling of the outlook for employment growth going forward. Formal sector employment as reported by Stats SA is already likely to remain relatively low over the near term – see Figure 8.

Figure 7: Employment in the retail sector



Source: BER

Figure 8: Surveys signal weak employment growth

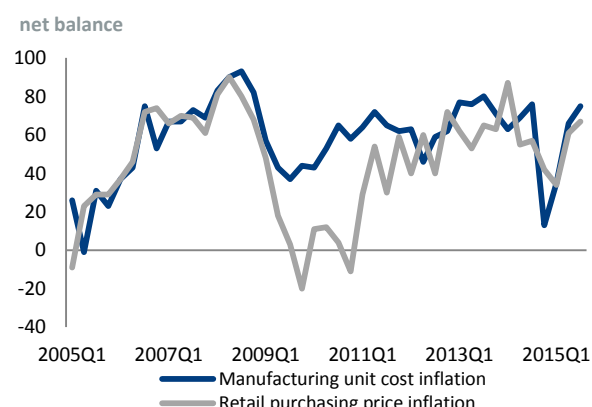


Source: BER, Stats SA

Costs continue to rise, implying pressure on profitability

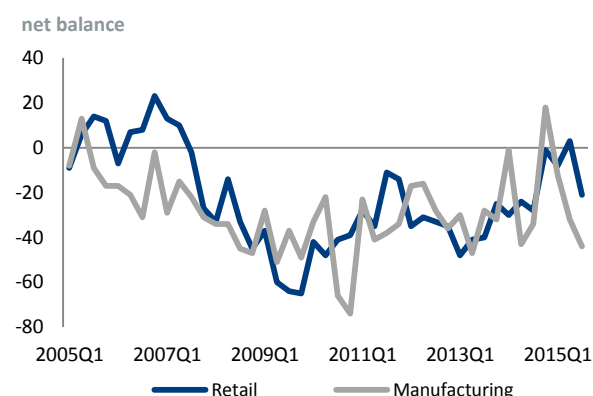
Cost pressures continued to mount in the third quarter. The continued weakness in the rand exchange rate probably played a key role. As shown in Figure 9, manufacturers and retailers reported a rise in the rate of increase in the average total cost per unit of production and average purchasing prices, respectively.

Figure 9: Costs continued to rise



Source: BER

Figure 10: Profitability came under pressure



Source: BER

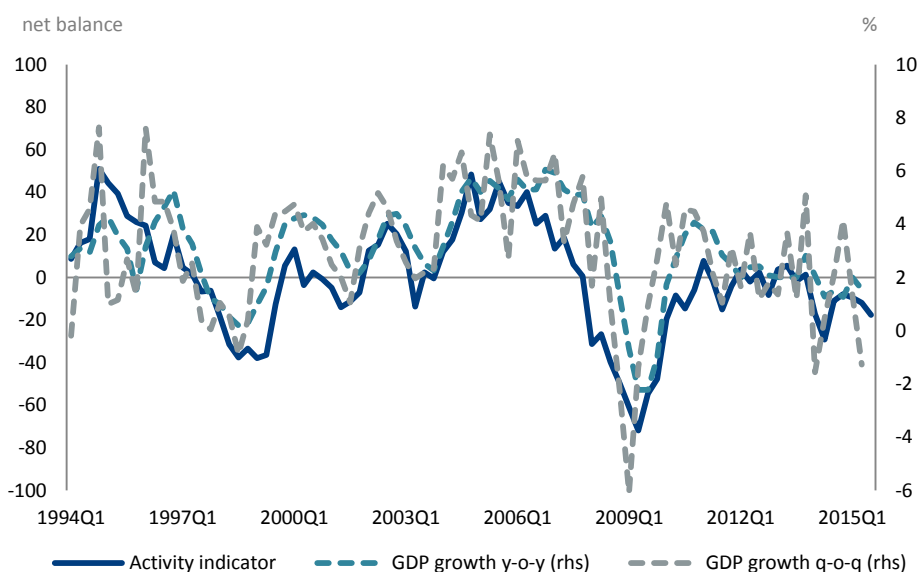
Selling price inflation remained around average levels, with weak demand forcing a lower rate of increase in domestic selling prices than both manufacturers and retailers expected. The combination of these factors implied that profitability came under significant pressure in Q3 (Figure 10).

Implications for the BER's macroeconomic forecast

The picture of weak domestic demand, pressure on costs and hence profitability, increased uncertainty, and a downscaling of fixed investment as well as employment is not promising for the overall economic outlook in Q3 and beyond. This after the shocking Q2 GDP reading of a 1.3% contraction q-o-q (seasonally adjusted and annualised).

Apart from the standard analysis and publication of the survey data, the BER also utilises the data in an attempt to extract information on both the business cycle and to estimate near-term economic growth. After considering the current round of survey results, both our business cycle algorithm and near-term GDP forecast were negatively impacted. Regarding the business cycle algorithm, the results indicate that it is likely that the economy is already in the downswing phase of the current business cycle. However, we will have to see a further drop in the overall RMB/BER BCI (to around 30 index points given current estimations) to confirm this notion. On the near-term GDP outlook, the survey results shaved off a significant portion of the predicted quarter-on-quarter growth for Q3. This was mostly due to the weaker than expected activity in the trade sector. At this stage, the BER is not forecasting a technical recession (i.e. a second consecutive quarter of decline in q-o-q GDP growth) for Q3, but there is scope for a slowdown in GDP on a year-on-year basis (see Figure 11). However, a recession could be on the cards should strike action or closures hit mining or manufacturing activity.

Figure 11: Average activity indicator from BER business surveys and GDP growth



Sources: BER, Stats SA

The BER will be updating its macroeconomic forecast after the release of the South African Reserve Bank's September Quarterly Bulletin. This should be available in the second week of October.

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