Business Expectations Survey September 2010 – Summary Review

1. Introduction

The BES is an important additional source of information on economic indicators for policy analysis and decision-making. The latest survey has been enhanced through additional questions.

The Bank undertakes the Business Expectation Survey (BES) twice-yearly, in order to collect information regarding perceptions among the local domestic business community about the prevailing state of the economy, as well as future prospects. Businesses are asked to respond to a range of questions relating to, among others, the business climate, gross domestic product (GDP) growth, inflation and business performance over the survey horizon, which is the next twelve months. The survey responses are mainly in the form of the anticipated direction of change: i.e., whether conditions will improve, worsen or stay the same. The results are then consolidated in the form of an overall 'net balance' between positive and negative responses. The major exception to this is the measure of overall business confidence which is presented on a gross basis. Thus, by design, the survey responses are predominantly qualitative, yet they provide valuable additional indicators to inform analysis.[1]

For this survey round, the questionnaire was expanded to include additional questions aimed at helping with the interpretation of the results. This is achieved through asking businesses to identify major challenges they face in doing business in Botswana and measures they think would help to improve the prevailing business and economic conditions. Firms were also asked to identify their preferred sources of financing (including by currency), while comments were sought on the relevance of the Bank of Botswana's medium-term policy objective of maintaining inflation in the range of 3-6 percent. Finally, the list of survey participants was updated to include some recently-established businesses while, at the same time, removing those that had a poor track record in responding to the questionnaire.

This report presents results[2] of the survey carried out between September and October 2010 for three distinct periods – the second half of 2010 (H2 2010; i.e., the current period), the first half of 2011 (H1 2011), and the whole of 2011 (H1-H2 2011). This is with the exception of questions on GDP and inflation that are measured on a calendar year basis to allow for comparison with official estimates of these data prepared by the Central Statistics Office. A total of 100 businesses are sampled from the agriculture, mining, manufacturing, water and electricity, construction, trade, transport, and banks, insurance and business services sectors. In the current survey, the response rate rose to 65 percent from 57 percent in the survey for March, 2010. This level of response is satisfactory; however, while every effort is made to maintain the response rate including follow ups with respondents, non-response remains a challenge that can affect the timeliness and the reliability of the results.

[1] The Appendix at the end of this report gives more details on the methodology.

[2] A summary of the main results is presented in Table 1 at the end of this report.

2. Survey Context: Recent economic Developments

The global economy continues to grow, although still under uncertain conditions. Prospects for the domestic economy remain positive, as mining continues to recover, although reduction in public spending may hold back domestic demand.

Recovery in the global economy has been maintained, although during the survey period there were increasing concerns about growth prospects in some developed economies as the impact of previous fiscal stimuli fades away and debt sustainability among economies in the periphery of the euro zone has become a focus of attention. The continuation of loose monetary policy to stimulate activity in developed countries has led to capital flows into emerging markets, including South Africa, resulting in currency appreciation and mounting international frictions as countries strive to retain competitiveness. However, despite these challenges, the IMF World Economic Outlook for October forecast world GDP growth of 4.8 percent in 2010 and 4.2 percent in 2011, while inflation is expected to remain subdued.

On the domestic front, the outlook is positive, as indicated by the Government's most recent forecast for GDP growth in 2010 of 7.9 percent. This reflects the continued recovery of the mining sector, as well as additional investment in the power and water sectors. While public spending is expected to remain broadly unchanged in nominal terms, it is falling in real terms, although the impact of this on the local economy may be offset by the increased emphasis in the Government procurement processes on support for local businesses. Nonetheless, with the size of the Government relative to the rest of the economy expected to decline, prospects for private sector growth will increasingly depend on implementation of measures to encourage local businesses to assume a greater role in fostering growth in the local economy.

3. Business Confidence and Performance

Businesses are increasingly confident about prevailing business conditions, especially among those supplying the local market. However, businesses anticipate higher input costs.

The overall confidence in the prevailing business conditions for H2-2010 is 56 percent, a slight improvement of 2 percentage points over 54 percent for the corresponding period (H1-2010) in the March survey. Looking ahead, there is a significant increase in confidence over the rest of the survey period with 67 percent of businesses expecting that conditions will be more favourable in H1 2011 and 73 percent for the 2011 as a whole.

Notably, the increasing optimism throughout the survey period is driven by domestic-oriented businesses. In contrast, among those that are focused on export markets only 40 percent are positive about current business conditions, although this does improve during 2011, rising to 60 percent. This marks a sharp reversal from the previous survey where the recovery in confidence was most pronounced among exporters and could reflect renewed concerns about the strength of the global recovery as well as the real appreciation of the Pula against currencies in which most major exports are denominated. At the same time, the confidence of domestic suppliers has been boosted by the Government's increased commitment to local procurement.

Many firms report either unchanged or declining levels of profitability, for which there is a negative net balance of -16.1 percent. However, consistent with improving confidence, a positive net balance of 23.7 percent is reported for the first half of 2011.Expectations are for increased production and sales in both the current period and the first half of 2011. However, volatility of exports is reflected in the expectations among export-oriented businesses that sales in H1-2011 will be less than in the same period in 2010.

Despite the overall optimism, it is widely expected that input costs will increase during 2011. For most input categories (raw materials, utilities, transport, rent, etc.), the net balance exceeds 70 percent throughout 2011, indicating near-unanimity in expecting increases. The widespread concerns about rising input costs with regard to utilities are likely to be driven by the cost implications of ongoing investment in both water and power infrastructure, while the depreciation of the Pula against the South African rand may be the underlying concern regarding costs of materials. Expectations of wage increases, although less pronounced, are also elevated, with a net balance of 54.5 percent in H1-2011. This possibly reflects an expectation of increased upward pressure on wages in the wake of the recent adjustment to civil service salaries, as well as the intention of public sector trade unions to push for further wage increases.

4. National Output

Survey respondents remain cautious about the overall growth of the domestic economy, despite the availability of information to the contrary.

Despite improving levels of confidence, it is noteworthy that businesses are somewhat pessimistic about the overall performance of the economy. Indeed, average expectations of GDP growth of 1.9 percent in 2010 and 2.9 percent in 2011 have fallen since the March survey (when the equivalent figures were 2.7 percent 3.3 percent, respectively). From this, it seems the businesses remain very cautious in the wake of the recent recession (the average expectation is weighed down by some extremely pessimistic responses). It should, however, be noted that such expectations are at odds with other publicly available information (GDP estimates for the first half of 2010 were available at the time of the survey, for example). In turn, this may suggest that such information, although available, is not disseminated effectively enough to the local business community.

5. Capacity Utilisation, Investment and Employment

Businesses plan to invest to support increased production. However, expectations of increased employment are only weakly positive, thus limiting prospects for additional jobs.

The strength of expectations regarding increased production and sales is underlined by clear indications that this will be met mainly through increases in capacity rather than improvements in capacity utilisation. Thus, an increase in investment in machinery and vehicles is expected in the second half of 2010, while expected levels of capacity utilisation remain broadly unchanged during 2011. By 2011 there is also some expectation of further investment in property. However, perhaps in anticipation of rising labours costs, the net balance for employment, although also positive, is only 7 percent in both H2-2010 and H1-2011.

6. Interest Rates and Debt

Survey respondents expect to increase their borrowing, despite anticipating increased interest rates. Most of the surveyed businesses do not regard credit conditions as tight.

There is a modest, although growing, appetite for continued borrowing during 2011, with net balances for all categories (domestic, South Africa, and elsewhere) rising significantly since the previous survey. There is some expectation of interest rates starting to rise again in 2011 (although further rate cuts in South Africa are expected in the first half of the year). Responding to the new questions in the questionnaire, 53.6 percent indicated that access to commercial bank credit is normal, as opposed to being easy (7.1 percent) or tight (39.3 percent). In addition, 53.6 percent of firms prefer to fund their operations from retained earnings, while only 23.2 percent preferred loans.

7. Inflation Outlook

Expectations of future inflation continue to moderate, although they are not yet anchored by the Bank’s inflation forecast. The Bank’s objective of controlling inflation is generally supported.

Businesses have again revised their inflation expectations downwards to an average of 7.8 percent for 2010 compared to 8.8 in the March 2010 survey. Similarly, inflation is expected to remain at an average of 7.8 percent in 2011 compared to the previous expectation of 9.5 percent. This suggests that expectations have continued to settle around prevailing rates of inflation but have yet to be anchored by the Bank’s forecast that inflation in 2011 will move within the objective range of 3 – 6 percent once the impact of the increase in VAT in April 2010 dissipates. In this respect, businesses may be heavily influenced by their own expectations of rising input costs and the impact of the gradual movement of the Pula towards parity with the rand.

Of the 80 percent of respondents that took advantage of the opportunity to comment on the Bank of Botswana’s inflation objective, 62 percent were of the view that it is both reasonable and achievable (although21 percent of these had some reservations about its achievability). For the remaining 38 percent, the objective was also seen as desirable, but they did not believe that it is easily attainable. Reasons for this included factors such as imported inflation (including the appreciation of the rand against the Pula), movements in administered prices and the conduct of fiscal policy, all of which could counter the impact on inflation expectations on the Bank’s commitment to restrain inflation.

8. Challenges

Challenges identified by businesses indicate the need to improve the business environment, including reduction of bureaucracy and improving access to skilled labour.

Responding to the new question on the main challenges currently facing businesses, the following were identified as the major constraints: the small domestic market; stiff competition; government bureaucracy; and shortages of skilled labour. A variety of other factors were mentioned, although less frequently, including: low productivity; the slow process for Government tenders; and difficulties in employing non-citizen labour. With many of the domestic-oriented businesses heavily dependent on government procurement, the intended reduction of government expenditure is seen as a challenge, with businesses struggling to gain a share of public procurement.

It is notable that access to bank financing is not listed as a major concern. This may, in part, reflect the preference for financing through retained earnings, but nonetheless indicates that other structural reforms to the business environment are more important for promoting growth and employment.

9. Conclusion

The results of the survey suggest an improvement in firms' perceptions of the business climate. This optimism is fuelling the willingness of businesses to invest more in order to increase production as they expect sales to rise. However, firms are still concerned with rising costs of production. This perception has resulted in the majority of them expecting inflation to remain above the Bank of Botswana's inflation objective in the coming year, the Bank's inflation forecast notwithstanding. However, it is notable among the survey respondents that there is strong support for the Bank's objective in terms of both its desirability and achievability, while businesses are more concerned by impediments to doing business other than access to and costs of banking services.

TABLE 1: SELECTED RESULTS FROM THE BUSINESS EXPECTATIONS SURVEYS OF MARCH AND SEPTEMBER 2010
(All results are percentages; all are net balances with the exception of overall business conditions, which are gross balances)

	MARCH 2010			SEPTEMBER 2010		
	H1 2010	H2 2010	H2 2010-H1, 2011	H2 2010	H1 2011	H1 -H2 2011
Output						
• Production	6.4	38.8		26.7	72.9	…
Expected level of stocks	2.9	12.5		-8.2	9.6	…
• Volume of sales	11.0	38.8		40.7	29.1	…
• Expected volume of goods exported	21.0	20.0		21.0	20.0	…
• Expected volume of goods imported	14.0	39.5		-14.0	39.5	
• Employment	…	-0.3	-2.95	…	7.0	7.1
• Profitability	-23.3	-11.1		-16.1	23.7	…
Input costs						
• Materials	…	-0.6	74.1	…	90.1	85.7
• Rent	…	3.6	76.2	…	59.9	83.3
• Utilities	…	66.2	84.6	…	75.3	89.1
• Wages	…	-0.3	63.9	…	54.5	7.1
• Transport	…	54.8	75.1	…	71.8	62.0
• Other	…	81.5	74.7	…	70.7	54.2
Investment						
• Buildings	21.8	29.2	…	-13.0	11.8	…
• Plant and machinery	38.2	32.9	…	25.1	27.2	…
• Vehicles and equipment	27.3	39.2	…	40.8	49.7	…
• Other	17.3	18.7	…	-33.4	-6.0	…
Expected volume of borrowing						
• Domestic	…	14.0	-1.0	…	28.6	19.6
• South Africa	…	-14.8	-15.2	…	14.0	19.1
• Elsewhere	…	6.3	6.7	…	25.70	23.1
Expected level of lending interest rates						
• Domestic	…	3.5	20.0	…	13.0	27.5
• South Africa	…	0.9	11.2	…	-18.2	8.0
• Elsewhere	…	43.9	53.8	…	28.9	32.3
Business Conditions						
Rating current business conditions satisfactory						
• Overall	55	…	…	56	…	…
• Exporters	57	…	…	40	…	…
• Domestic	55	…	…	58	…	…
Optimistic about business conditions in 6 months' time						
• Overall	…	54	…	…	67	…
• Exporters	…	57	…	…	50	…
• Domestic	…	53	…	…	70	....
Optimistic about business conditions in 12 months' time						
• Overall	…	…	71	…	…	73
• Exporters	…	…	86	…	…	60
• Domestic	…	…	69	…	…	75

APPENDIX : METHODOLOGY

1. In processing the BES results the following methodologies were used. The methods as applied more generally and specifically in this Report are discussed below. They closely follow those used by the OECD and to some extent by the Bureau of Economic Research (BER) in South Africa.

2. The first step is to assign the plus (+), minus (-) and equal (=) signs to responses to each question in accordance with the following criteria. The (+) sign is used to denote the following responses: increase or higher or more or above normal; the (-) sign to denote decrease or lower or less or below normal; and the (=) sign to denote same or normal or uncertain. Even with this type of coding, responses to multiple choice questions are difficult to interpret when all are presented simultaneously. Because of this difficulty, BES results are normally converted into a single number through the use of net balances (B). The net balance method transforms all responses to a particular question to percentages and discards the percentage of (=) responses and subtracts the percentage of (-) responses from the percentage of (+) responses, i.e., B = 100 (P – N), where B is the net balance and takes values from –100 to +100, P is the percentage of (+) responses in the total and N is the percentage of (-) responses in the total. Experience elsewhere, notably in the OECD, shows that this loss of information is unimportant for most uses of the BES information and that for such purposes as cyclical analysis the use of net balances is considered both practical and adequate. If, however, this information is considered important, it can be shown along with the net balances information. In addition, changes in the percentage of (=) replies can be interpreted as showing changes in the degree of uncertainty among respondents.

3. In the Report, the majority of the survey results are reported on a net balance basis, a few on a gross balance basis (e.g., current business conditions) and yet others for which quantitative data were directly collected, e.g., inflation and national output growth rates no netting or grossing is done, they are reported as annual averages. Net balances, as defined above, are used without the explicit reference to the term 'net'. Where a different concept of the word balance is used, e.g., gross, an appropriate qualifying word is included.

4. What follows is an example of how the net balances are interpreted. If 80 percent of the respondents expect an increase in investment expenditure in Q2 of 2003 compared with the same quarter in 2002, 10 percent expect a decrease, while 10 percent expect no change and/or are uncertain, it can be concluded that the net majority (70 percent = 80 percent – 10 percent) of respondents expect to increase investment expenditure in the next quarter. The reverse – that investment expenditure is expected to fall – would be true if the net balance was a negative 70 percent. A net balance value between 0 and 100 indicates an improvement compared to the corresponding period in the past, between 0 and –100 a deterioration, and 0 no change.

5. The business confidence index (BCI) reflects business conditions at a particular point in time and thus there is no comparison with a past corresponding period. Unlike the reporting of most other results, the BCI is reported on a gross basis. That is, it is calculated as the percentage of respondents indicating 'satisfactory' conditions to the total number of respondents indicating 'unsatisfactory' and 'satisfactory' conditions. The BCI value varies from 0 to 100, with zero indicating extreme lack of confidence while 100 indicates extreme confidence. As an example, a BCI value of 40 percent is interpreted to mean that 40 percent of all respondents (gross) rated prevailing conditions as satisfactory.