

# **Business Expectations Survey March 2011 – Summary Review**

## **1. Introduction**

The BES is an important additional source of information on economic indicators for policy analysis and decision-making. The response rate remains satisfactory.

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 exceptions to this are the measure of overall business confidence as well as the question on major challenges, both of which are presented on a gross basis. Thus, by design, the survey responses are predominantly qualitative, yet they provide valuable additional indicators to inform analysis.<sup>1</sup>

This report presents results of the business outlook survey carried out between March and May 2011<sup>2</sup> for three distinct periods: the first half of 2011 (H1 2011; i.e. the current period); the second half of 2011 (H2 2011), and the twelve-month period to June 2012 (H2:2011-H1:2012). However, in line with data produced by Statistics Botswana (formerly the Central statistics Office or (CSO)), inflation and national output are measured in calendar years, to allow for comparison. The survey sample covers 100 businesses in agriculture, mining, manufacturing, water and electricity, construction, trade, transport, and financial and business services. Completed questionnaires were received from a total of 65 firms, maintaining the same response rate as in the previous survey. Overall, the level of response remains satisfactory; however, considerable effort continues to be required to ensure that sufficient participants submit questionnaires in time for their inclusion in the survey results.

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<sup>1</sup> The Appendix at the end of this report gives more details on the methodology.

<sup>2</sup> A summary of most of the results is shown in Table 1.

## **2. Survey Context: Recent economic Developments**

The global economy continues to grow, driven mainly by emerging markets, while the outlook for developed economies remains uncertain. 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 world economy continues, with emerging markets increasingly driving global growth. Global GDP is projected to grow by 4.5 percent both in 2011 and 2012.<sup>3</sup> However, while emerging markets are expected to grow at 6.5 percent during 2011, developed economies continue to lag behind with anticipated growth of 2.5 percent. Confidence in developed economies continued to be weighed down by high levels of unemployment and the problems of achieving debt sustainability among the periphery of the euro zone. In contrast, emerging markets continue to exhibit strong demand which has boosted commodity prices to the benefit of commodity-exporting economies, including in Africa. Nonetheless, in its most recent economic review, the African Development Bank warned of growing downside risks to economic growth in Africa, arising in part from political instability in North Africa and the Middle East which increased uncertainty surrounding future trends in international oil prices that have added further to inflationary pressures.

Regarding the domestic economy, renewed buoyancy in the mining sector is expected to boost overall economic performance. As a result, the forecast by the Ministry of Finance and Development Planning (which was publicly available at the time of the survey) is that real GDP will grow by 6.8 percent in 2011. The economy has also been boosted by ongoing major infrastructure investments, both by the Government and private sector. This buoyant outlook notwithstanding, the survey was conducted during a period when growing downside risks may have weighed on the minds of respondents, including plans to rein in government spending and the commencement of the public service strike.

## **3. Business Confidence and Performance**

Businesses confidence has fallen somewhat since the previous survey. However, this is expected to recover during the outlook period covered by the survey, especially among exporters.

For the first half of 2011, 47 percent of firms were satisfied with prevailing business conditions, which is a substantial reversal compared to the previous survey where 67 percent expressed optimism about the same period. There is some recovery in confidence for the rest of the survey period with 64 percent anticipating more favourable conditions in the second half of 2011, rising to 67 percent by 2012. However, while this could reflect expectations of more settled economic conditions from the second half of the year, it seems apparent from the large swings between surveys that business confidence remains fragile.

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<sup>3</sup> IMF World Economic Outlook Updates, April 2011.

As in the previous survey, export oriented firms<sup>4</sup> are less positive about current conditions, with 43 percent reporting satisfaction, compared to 47 percent reported by domestic-oriented firms. This changes from the second half of 2011, for which expected satisfaction with business conditions among exporting firms surges to 71 percent, while confidence among non-exporters also rises, to 63 percent; there is a further increase to 86 percent and 65 percent, respectively, going into 2012. One potential explanation for the stronger recovery in confidence among exporters is the continuing improvement in prospects for the mining sector. For non-exporting domestic producers, there may be some anticipation of benefits starting to accrue from Government plans to prioritise them in future procurement programmes, although this may be held back by concerns over reductions in overall government spending.

#### **4. National Output**

Survey respondents remain cautious about the overall growth of the domestic economy, despite the availability of information to the contrary. The mining sector is generally the most optimistic about domestic growth prospects.

Current subdued levels of confidence are reflected in expectations regarding national output where respondents expect the economy to grow by 2.1 percent in 2011, down from 3.3 percent in the previous survey. This would imply a sharp divergence from both the authorities' growth forecasts and growth in 2010, which is estimated at 7.2 percent, both of which were available for at least part of the period during which the survey was undertaken. As has been noted previously, as well as caution among respondents who might base growth perceptions on their own immediate prospects, this could reflect a lack of effective dissemination of official statistics. In line with increasing optimism regarding business conditions in future periods, respondents expect a modest pick-up in 2012 with growth of 3.2 percent. Among respondents, mining companies are the most optimistic about future GDP growth, although this is tempered by more caution among mining businesses (such as quarries) that produce for the domestic market.

#### **5. Capacity Utilisation, Investment and Employment**

Businesses plan to invest to support increased production, and draw down their stocks to meet increased sales. However, businesses continue to anticipate higher input costs.

Both domestic- and export-oriented firms expect to increase production and investment levels, and to draw from their stocks in the current and subsequent half-year periods, presumably to meet the expected increase in sales. In turn, this translates into expectations of improved profitability. While current expectations of rising profits during (H1-2011) are moderate with a net balance of 16.2 percent, this rises sharply to 51.1 percent in (H2-2011). Again, this is consistent with a more settled economic environment emerging in the second half of the year. Although sentiments amongst respondents regarding rising input costs are somewhat less

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<sup>4</sup> Firms whose main market is export constitute a small number (7/65) of the respondents. Most of these are from the manufacturing sector, with others from mining and trade.

pronounced than in the previous survey, there are still widely-held expectations of rising costs of materials, rent, utilities, wages, transport, etc., throughout the outlook period.

## **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, while remaining more inclined to rely on retained earnings.

Despite the general expectation of rising interest rates in all markets (domestic and foreign), especially towards the end of the outlook period, businesses expect to raise their borrowing, with net balances more positive than in the previous survey. A majority of respondents (55.2 percent) indicated that they would finance their operations through retained earnings, compared to 29.3 percent and 15.5 percent, respectively, preferring to opt for loans or equity. Most respondents also consider access to credit from commercial banks to be normal, although only 8.3 percent regard credit as being easily accessible compared to 30 percent that describe borrowing conditions as tight.

## **7. Inflation Outlook**

Expectations of future inflation continue to moderate, although they do not yet coincide with the Bank's inflation forecast. The Bank's objective of controlling inflation is generally supported, and the 3 – 6 percent objective is increasingly seen as achievable.

Expectations for average inflation in 2011 have continued to edge down to 7.5 percent compared to 9.5 percent and 7.8 percent, respectively, in March and September 2010. This is despite recent increases in headline inflation, which has averaged 8.2 percent in the first four months of 2011. For 2012, firms expect inflation to fall further to an average of 7.3 percent. This is increasingly close to the Bank's own forecast, which may in turn indicate that more attention is now being paid to those forecasts, at least by survey participants.<sup>5</sup>

Nonetheless, only a minority of respondents (19 percent in 2011 rising to 25 percent in 2012) believe that inflation will fall within the 3 - 6 percent objective range during the period covered by the survey. At the same time, 54.7 percent believe that the Bank's objective is reasonable and achievable compared to 40.4 percent in the previous survey. In addition, the proportion that supports the current objective, but feels it would be difficult to achieve has dropped markedly from 21.2 percent to 5.7 percent. However, there was a marginal increase in those that felt that the objective is not achievable from 38.5 percent to 39.6 percent.

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<sup>5</sup> It is possible that respondents are more aware of the Bank's policy objectives as a result of the survey report being sent to them.

## **8. Challenges**

In addition to the limited size of the domestic market, challenges identified by businesses indicate the need to improve access to skilled labour and the business environment, including reduction of bureaucracy.

As in the previous survey, when this question was first introduced, domestic demand remains the dominant factor that influences business decisions and perceptions regarding the business environment. Among a list of thirteen possible factors that respondents were asked to choose from, the five most important were domestic demand (23.6), availability of skilled labour (10.1 percent), and the regulatory and supervisory frame work, availability of raw materials and the exchange rate (all 8 percent). Factors that could have the most positive impact on business decisions included domestic demand, the political climate, and the availability of raw materials and skilled labour. In contrast, businesses were concerned about the potentially negative impact of the small size of the domestic market, the local availability of skilled labour, the regulatory framework and adverse movements in the exchange rate.

## **9. Conclusion**

Although business confidence is currently low, respondents were hopeful that the conditions will improve in future. However, such expectations appear to be fragile and heavily dependent on the state of the domestic market. It may be anticipated, therefore, that confidence could easily deteriorate in the face of signs that domestic demand is weakening. In this regard, it is notable that the survey was conducted before the full extent of the disruption, including to consumer purchasing power, of the civil service strike became apparent. Regarding inflation expectations, the continued downward revisions may provide some encouragement that businesses are increasingly guided by, if not yet fully aligned with, the Bank's inflation objective, whereas in the past they tended to expect inflation to rise regardless of the Bank's monetary policy. Nonetheless, while there appears to be broad-based support for the Bank's policy, there remains significant scepticism that the inflation objective will be achieved in the near future.

**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 2011			SEPTEMBER 2010		
	H1 2011	H2 2011	H2 2011 - H1 2012	H2 2010	H1 2011	H1-H2 2011
<b>Output</b>						
• Production	27.2	47.8		26.7	72.9	...
• Expected level of stocks	-2.4	-1.9		-8.2	9.6	...
• Volume of sales	43.8	48.2		40.7	29.1	...
• Expected volume of goods exported	8.9	25.1		21.0	20.0	...
• Expected volume of goods imported	13.6	45.1		-14.0	39.5	
• Employment	...	2.3	25.5	...	7.0	7.1
• Profitability	16.2	51.1		-16.1	23.7	...
<b>Input costs</b>						
• Materials	...	75.1	73.2	...	90.1	85.7
• Rent	...	49.5	43.1	...	59.9	83.3
• Utilities	...	47.1	79.1	...	75.3	89.1
• Wages	...	55.4	87.0	...	54.5	7.1
• Transport	...	78.5	81.6	...	71.8	62.0
• Other	...	66.8	76.6	...	70.7	54.2
<b>Investment</b>						
• Buildings	19.2	30.1	...	-13.0	11.8	...
• Plant and machinery	54.3	78.4	...	25.1	27.2	...
• Vehicles and equipment	50.8	52.4	...	40.8	49.7	...
• Other	38.1	58.9	...	-33.4	-6.0	...
<b>Expected volume of borrowing</b>						
• Domestic	...	30.4	30.1	...	28.6	19.6
• South Africa	...	30.6	38.5	...	14.0	19.1
• Elsewhere	...	14.7	14.7	...	25.70	23.1
<b>Expected level of lending interest rates</b>						
• Domestic	...	0.0	26.7	...	13.0	27.5
• South Africa	...	23.6	46.0	...	-18.2	8.0
• Elsewhere	...	30.6	58.7	...	28.9	32.3
<b>Business Conditions</b>						
Rating current business conditions satisfactory						
• Overall	47	...	...	56	...	...
• Exporters	43	...	...	40	...	...
• Domestic	47	...	...	58	...	...
Optimistic about business conditions in 6 months' time						
• Overall	...	64	...	...	67	...
• Exporters	...	71	...	...	50	...
• Domestic	...	63	...	...	70	...
Optimistic about business conditions in 12 months' time						
• Overall	...	...	67	...	...	73
• Exporters	...	...	86	...	...	60
• Domestic	...	...	65	...	...	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.