BUSINESS EXPECTATIONS SURVEY SEPTEMBER 2005: SUMMARY REVIEW

1. INTRODUCTION

1.1 This note summarises the main results of the Business Expectations Survey (BES) conducted from September to November 2005, covering the second half of 2005 and both halves of 2006. One hundred firms were surveyed, of which 46 percent responded (compared to 60 percent in the previous survey), across a variety of economic sectors. Given the small size and the low response rate, the results need to be interpreted with caution. Expectations may also have changed during the period between the conduct of the survey and the publication of the results.

1.2 The written summary of the main results is accompanied by a short note on methodology and an accompanying table.

2. CONFIDENCE AND PROFITABILITY

2.1 Business confidence was very low in the second half of 2005 (H2 2005) with only 28 percent of respondents seeing business conditions as satisfactory. Only 25 percent expected improvements over the next six months although this rises to 36 percent for 2006 as a whole. These figures indicate a sharp drop in overall business confidence since the previous survey when 40 percent were satisfied with overall conditions and 57 percent expected improvements over the following year. However, export-oriented businesses indicated both a much higher (if still only moderate) level of confidence at 57 percent in H2 2005 and further improvements in 2006. A possible explanation for this optimism shown by exporters is the expected impact of the Pula devaluation in May 2005. On the other hand, lower business confidence (specifically, 21, 22 and 32 percent for the three surveyed periods) among non-exporters reflects weak domestic demand, which was the main reason given for current dissatisfaction. Expectations by the business community place GDP growth at 4 – 5 percent in 2004/05 and 2005/06, much lower than the previous survey's expectations of about 6 percent.

2.2 In line with the weakened business confidence in H2 2005 and H1 2006, profitability is expected to go down in the two periods. This trend is in line with the expected decline in the volume of sales in the respective periods

3. EMPLOYMENT, INVESTMENT & WAGES

3.1 In contrast to falling business confidence, the survey indicates broadly constant expectations regarding employment with a small positive net balance (5.5 percent compared to 2.0 percent in the previous survey) expecting additional jobs to be created. Again there is a marked difference between export- and domestic-oriented businesses: for 2006 as a whole 55 percent of exporters were optimistic about job creation, while non-exporters saw no change in employment levels.

3.2 Overall, the level of investment was expected to remain positive across all categories (new buildings, vehicles and equipment and other investment). However, disinvestment was expected in H2 2005 and H1 2006 in both the construction and trade sectors. This is consistent with the on-going dissatisfaction by construction firms with business conditions, while the trade sector is significantly affected by sluggish domestic demand, especially given the expansion in capacity of the sector in recent years

3.3 Expectations were that input costs will have risen across nearly all sectors compared to the last survey, from already high levels. This is presumably due to increased inflation expectations. Nearly 100 percent of respondents expect high transport costs during 2006, a clear reflection of the impact of higher fuel prices, while almost 90 percent expect upward pressures on wages, an apparent reference to a possible compensating response to the diminished purchasing power due to the devaluation of the Pula.

4. Debt and Business Financing

4.1 Despite the relatively positive outlook toward investment, businesses showed little appetite for increased borrowing and may even be looking to reduce their indebtedness (especially external liabilities) during 2006. This is consistent with interest rate expectations, which have changed significantly since the last survey. Whereas previously, 21 percent of respondents had expected cuts in domestic interest rates by H1 of 2006, 17 percent now expect further increases, and this rises to 27 percent for the full year. Forty-three percent expect higher interest rate in South Africa by H1 2006.

5. Inflation

5.1 For 2005 and 2006, expectations were for average inflation at 9.2 and 9.6 percent respectively, up from about 7.5 percent in the previous survey. Over 90 percent of respondents expected average inflation to be more than 7 percent, i.e., above the Bank's revised inflation objective range of 4 – 7 percent for 2005. Such a shift in expectations is broadly consistent with the forecast impact of the May 2005 devaluation, the effects of which are concentrated in H2 2005 and H1 2006, and may provide some reason for optimism that expectations of high inflation beyond that time are not entrenched.

6. Conclusion

6.1 Overall, the balance of business expectations was unambiguously pessimistic about economic performance although a reasonably positive rate of output expansion is expected. Confidence levels are sharply down reflecting less optimism regarding GDP growth, profits and sales volumes combined with increased expectations of rising input costs. However, indicators are not uniformly negative. There is a striking division between export- and domestic-oriented businesses, with the former having a much more positive outlook. In turn *this may reflect a positive reaction towards the devaluation among exporters contrasted to concerns about domestic demand. The significant but restrained upward impact of the devaluation on inflation expectations is also a positive sign. Overall the survey results appear internally consistent and in line with what would be expected in the immediate post devaluation period.*

TECHNICAL NOTE – SURVEY SAMPLE AND METHODOLOGY

a) *This survey is carried out biannually covering 100 businesses in agriculture, mining, manufacturing, water and electricity, construction, trade, transport and banks, insurance and business services. For purposes of consistency and continuity, in most instances the same businesses are covered in each round of the survey. Of these businesses, 72 percent were large-scale and 28 percent medium-scale, with size classification being based on number of employees (e.g., large = 100+). By way of comparison, the quarterly balance of payments survey only covers about 40 businesses.*

b) *This report covers the survey carried out between September and October 2005, for the periods H2 2005, H1 2006 and H1 2005 – H2 2006. There is however, a departure from these periods for questions concerning output and inflation, where, respectively, the national accounting (July – June) and calendar years are used.*

c) *The survey questions cover firm's expectations regarding general business conditions, national output, company production and capacity, stocks/inventories, volume of sales, imports of goods and services, employment, input costs, investment, profitability, company borrowing, and inflation. Questions typically require 'relative responses' (higher or lower, more or less, satisfactory to unsatisfactory, etc.). However, questions on national output and inflation require more specific numerical answers.*

d) *The methodology used closely follows those used by the OECD and to some extent by the Bureau of Economic Research (BER) in South Africa.*

SELECTED RESULTS FROM THE BUSINESS EXPECTATIONS SURVEYS, MARCH AND SEPTEMBER 2005

(All results are percentages; all are net balances except overall expectations, which are gross balances)

	March Survey			*September Survey*		
	H1 2005	**H2 2005**	**H2 2005-H1 2006**	**H2 2005**	**H1 2006**	**H1 2006-H2 2006**
Production of firm	10.56	29.22	…	-34.24	-19.01	…
Expected level of stocks	4.23	-8.03	…	-44.37	-35.24	…
Volume of sales	0.20	29.40	…	-21.25	-2.64	…
Expected volume of goods exported	53.93	75.23	…	89.33	33.59	…
Expected volume of goods imported[1]	11.16	9.37		3.16	0.39	
Employment	…	0.76	2.01	…	6.84	5.45
Input costs						
• Materials	…	70.67	83.80	…	81.86	92.08
• Rent	…	50.82	70.66	…	68.94	83.58
• Utilities	…	70.17	85.25	…	77.74	83.13
• Wages	…	81.05	85.87	…	72.68	89.24
• Transport	…	79.58	87.69	…	87.12	97.34
• Other	…	82.62	88.78	…	92.68	93.75
Investment						
• Buildings	-10.00	-6.82	…	19.49	18.95	…
• Plant and machinery	39.09	25.50	…	31.43	22.60	…
• Vehicles and equipment	27.25	48.38	…	50.41	34.81	…
• Other	5.58	8.96	…	13.54	14.61	…
• Profitability	-30.60	1.42	…	-38.28	-37.96	…
Expected volume of borrowing						
• Domestic	…	9.50	3.72	…	-4.72	1.27
• South Africa	…	-21.47	-17.72	…	-4.31	-16.40
• Elsewhere	…	16.32	14.04	…	2.16	-13.77
Expected level of lending interest rates						
• Domestic	…	-3.98	-20.98	…	17.09	27.35
• South Africa	…	-25.45	10.41	…	43.00	0.88
• Elsewhere	…	12.28	5.67	…	30.81	28.78
Business Conditions						
% Rating current business conditions satisfactory[2]	40	…	…	28	…	…
% Optimistic about business conditions in 6 months' time[2]	…	42	…	…	25	…
% Optimistic about business conditions in 12 months' time[2]	…	…	55	…	…	36