Business Expectations Survey September 2006: Summary Review

1. INTRODUCTION

1.1 This report presents a summary of the seventh Business Expectations Survey (BES) carried out in September and October 2006 for three distinct periods: the second half of 2006 (H2 2006), the first half of 2007 (H1 2007) and the twelve-month period to December 2007 (H1–H2 2007). Sixty three of the 100 firms surveyed responded, a marginal improvement on the response rate of 61 percent obtained in the previous survey. Despite the gradual improvement in the response rate, problems associated with conclusions based on a small sample size remain, especially for the exporters, which comprise only a small group within the survey. A summary of the main results is shown in Table 1.[1]

2. CONFIDENCE AND PROFITABILITY

2.1 There is continued optimism among respondents about economic activity, with expected GDP growth rates remaining in the range of 6.5 – 7.0 percent for 2005/06 and 2006/07. This optimism is reflected in the continuing resurgence of business confidence, which stands at 52 percent for H2 2006 compared to 40 percent recorded in the last survey, thus moving overall confidence above the 'neutral' level.[2] This rises further to 65 percent for H1 2007 (up from 55 percent) and 78 percent (the highest level recorded so far in these surveys) by the end of the year. As with the previous two surveys, there is a marked difference between the confidence of exporters and non-exporters. However, the gap is narrowing. Confidence among exporters for H2 2006 is 57 percent rising to 87 percent throughout 2007. But, in contrast to the last survey where their confidence levels were only around 40 percent, locally-oriented businesses are also reportedly more optimistic, at 52 percent in H2 2006, 63 percent in H1 2007 and 77 percent for the whole of 2007.

2.2 The apparent significant upward shift in business confidence is particularly notable in comparison to other reports of possible weak contribution of government expenditure to output expansion as public spending continues to grow at a slower pace despite the expansionary budget announced for 2007. To some extent this may be reflected through lower levels of confidence in the manufacturing and construction sectors. It is possible that, despite short term concerns, local businesses believe that government spending, as well as other components of domestic demand, will start to increase.

2.3 The continuing improvement in business confidence is to some extent supported by generally solid expectations across an array of output-related indicators such as production, sales, imports and exports. However, expectations about profitability remain

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1 *Unless otherwise stated, percentage changes refer to a net balance of opinion or expectations about the direction of change in a particular variable, i.e., the difference in percentage terms between positive responses (e.g., increase, higher) and negative responses (e.g., decrease, lower). Gross percentage changes refer to the proportion (in percent) of respondents that answered in a specified manner (see technical note on sampling and methodology).*

2 *The business confidence measure is calculated as the proportion (in percent) of respondents that said business conditions were 'satisfactory'. The business confidence measure takes values from 0 to 100, with 0 indicating extreme lack of confidence, 100 extreme confidence, and 50 neutrality.*

subdued, with negative net balances (i.e., an overall expectation of lower profits) in both H2 2006 and H1 2007, although there is some improvement in the latter period when the net balance improves from -20 to -3 percent. This serves to emphasise that any recovery of confidence is from very low levels, as indicated by the September 2005 survey.

3. EMPLOYMENT, WAGES AND INVESTMENT

3.1 Prospects for employment remain positive, with net balances of around 14 percent throughout 2007.

3.2 Nearly all the surveyed firms expected input costs to increase further, a sentiment largely unchanged since the previous survey. This is most notable with regard to raw materials and transport costs, indicating expectations of continuing depreciation of the Pula and, despite recent reductions, concerns about high fuel prices. However, there are somewhat lower expectations of increases in some categories of domestic inputs. In particular, expectations of higher wages and rents have fallen compared to the previous survey. This could be due to declining inflation easing concerns about upwards pressure on wages together with an excess supply of commercial buildings.

3.3 Businesses anticipate a rise in their investment spending in both H2 2006 and H1 2007. There are significant positive balances across all categories of physical investment, most notably in the 'plant and machinery' and 'vehicles and equipment' categories.

4. DEBT AND BUSINESS FINANCING

4.1 Concerns about higher interest rates appear to be easing. There is still a positive net balance of 25 percent of businesses expecting higher costs of borrowing in the first half of 2007, but there is now some expectation among the survey respondents that interest rates will have started declining towards the end of 2007. Over the same period, however, there is still negative sentiment against increasing external borrowing, although somewhat less strong than in the previous survey. With domestic borrowing set to remain flat or even contract, it appears that there will be strong emphasis on use of own funds to finance investment. Following recent interest rate increases by the South African Reserve Bank (SARB), expectations of higher borrowing costs in South Africa have increased markedly; conversely, worldwide interest rates are expected to start falling, especially in the second half of 2007.

5. Inflation

5.1 During the previous survey, businesses expected average inflation to be 11.5 percent in 2006 and 10.5 percent in 2007. These have now been revised downwards to 9.5 and 9.1 percent, respectively. While this suggests that the surveyed firms anticipate that inflation will remain above the upper limit of the Bank's three-year inflation target range of 3-6 percent, the expectation is for a fall in inflation from the levels prevailing when the survey was conducted. The easing of inflationary expectations is not surprising: the previous survey was conducted prior to the downward revisions by the Central Statistics Office of the January – March 2006 inflation data, and there has since been a sustained series of fall in inflation as the impact of the May 2005 devaluation falls away.

6. Conclusions

6.1 The survey results indicate that, overall, economic prospects for the remainder of 2006 and 2007 remain positive. On the basis of these survey results, uncertainties over prospective domestic demand conditions, as well as other downside risks to output, such as higher costs of production and costs of borrowing, have started to diminish, easing constraints, especially in the non-mining private sector. Overall business confidence is sharply higher and now in positive territory due, in particular, to increased confidence among domestic oriented businesses. While this result must be treated with some caution, especially given the current slow implementation of the 2006/07 Government budget on which many businesses depend, it appears to be broadly supported by a range of other indicators in the survey. The continued high confidence levels among exporters most likely reflects mainly positive trading conditions arising from high prices of commodities and, possibly, the favourable impact on exporters' revenues of the May 2005 devaluation and the introduction of the crawling band exchange rate mechanism.

6.2 While expected inflation in 2007 remains above both the Bank's short- and medium-term objectives, it is encouraging that expectations of inflation appear to be coming down. This continues to provide cause for optimism that the Bank's efforts to curb inflationary expectations are bearing fruit. While inflation has been on a downward trend since the middle of 2006, expectations of future interest rate cuts only start appearing by late 2007, indicating an appreciation that the Bank remains willing to maintain a tight monetary policy stance in pursuit of its objectives.

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 (i.e., 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 March and April 2006, for the periods H1 2006, H2 2006 and H2 2006 – H1 2007. 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 Organisation for Economic Cooperation and Development (OECD) and, to some extent, by the Bureau of Economic Research (BER) in South Africa.

SELECTED RESULTS FROM THE BUSINESS EXPECTATIONS SURVEYS, SEPTEMBER AND MARCH 2006

(All results are percentages; all are net balances with the exception of overall business conditions, which are gross balances)

	MARCH 2006			SEPTEMBER 2006		
	H1 2006	*H2 2006*	*H2 2006-H1 2007*	*H2 2006*	*H1 2007*	*H1 2007-H2 2007*
Output						
• *Production*	28.1	70.4	…	49.5	60.7	…
• *Expected level of stocks*	-14.3	5.6	…	-24.6	-10.6	…
• *Volume of sales*	19.9	56.9	…	36.9	59.7	…
• *Expected volume of goods exported*	3.8	67.2	…	59.4	60.3	…
• *Expected volume of goods imported*	21.8	60.3		52.7	68.2	
• *Employment*	…	4.9	27.3	…	14.4	12.9
• *Profitability*	-1.0	29.0	…	-19.7	-2.7	…
Input costs						
• *Materials*	…	95.1	94.0	…	88.1	83.6
• *Rent*	…	66.9	85.8	…	43.5	69.0
• *Utilities*	…	80.3	84.4	…	81.7	80.4
• *Wages*	…	81.4	92.2	…	55.3	77.9
• *Transport*	…	94.4	90.8	…	93.8	90.9
• *Other*	…	91.3	89.5	…	91.4	94.2
Investment						
• *Buildings*	22.01	15.5	…	39.0	21.6	…
• *Plant and machinery*	22.31	41.0	…	45.0	50.2	…
• *Vehicles and equipment*	43.16	58.6	…	63.0	76.4	…
• *Other*	21.34	29.4	…	50.5	47.9	…
Expected volume of borrowing						
• *Domestic*	…	4.0	-14.0	…	23.4	-6.4
• *South Africa*	…	-33.8	-36.7	…	-8.0	-8.7
• *Elsewhere*	…	-44.1	-50.6	…	8.1	-1.6
Expected level of lending interest rates						
• *Domestic*	…	36.2	41.8	…	25.2	-9.2
• *South Africa*	…	8.6	3.7	…	49.8	15.2
• *Elsewhere*	…	-23.9	-23.4	…	-7.4	-20.7
Business Conditions						
Rating current business conditions satisfactory	43	…	…	52	…	…
Optimistic about business conditions in 6 months' time	…	40	…	…	65	…
Optimistic about business conditions in 12 months' time			55	…	…	78