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BUREAU FOR ECONOMIC RESEARCH

Retail Trade

Quarterly analysis of activity in retail, wholesale and motor trade

Fourth quarter 2017

UNIVERSITEIT
STELLENBOSCH
UNIVERSITY

Editor: **HarriKemp**

Linette Ellis

Email: jhkemp@sun.ac.za

Tel: +27 21 887 2810

Fax: +27 21 883 3101

Technical assistance:

Ester Manefeldt

Language Editor:

Jenny Tucker

Executive summary

The 2017Q4 BER Retail Survey indicates that business confidence among retailers deteriorated on the back of weak underlying demand and reduced profitability. In all, low levels of consumer confidence, subdued growth in consumers' real disposable income and the increased pace of fiscal consolidation should keep a lid on retail sales growth, and overall consumer spending, over coming quarters.

According to the latest BER Retail Survey, 29% of retailers reported being satisfied with prevailing business conditions in 2017Q4, down from 38% in Q3. The majority of retailers reported that business conditions deteriorated relative to a year ago, while sales volumes remained under pressure. Combined with increased pressure on margins, lower volumes resulted in a drop in profitability and confidence.

Trading conditions deteriorated notably in the semi-durable and non-durable categories, with clothing and footwear retailers in particular reporting weak numbers. Encouragingly, durable goods retailers posted better results following several quarters of underperformance.

Wholesaler confidence remained broadly unchanged despite an improvement in underlying business conditions. In all, 51% of wholesalers reported being satisfied with prevailing trading conditions. Conditions deteriorated in the non-consumer goods category as weak domestic demand and the underperformance of the mining and manufacturing sectors weighed on activity. In contrast, consumer goods wholesalers posted better results, suggesting consumers might be bypassing retailers and buying directly from wholesalers.

New vehicle trader confidence continued to recover, ticking up from 19 index points in 2017Q3 to 32 in Q4. Confidence is likely being underpinned by the recent uptick in new passenger car sales. While new vehicle traders expect conditions to improve further in 2018Q1, weak disposable income growth, subdued credit growth and low consumer confidence should keep a lid on passenger car sales going forward.

The trade sector expanded by 0.6% q-o-q (annualised) in 2017Q2 after contracting by 5.9% q-o-q in the first quarter. While retail sales expanded by another 5% q-o-q (annualised) in 2017Q3, wholesale volumes contracted by over 10%, suggesting that the trade sector as a whole remains under pressure. However, despite the recent uptick in retail sales volume growth, the consumer environment remains weak. Subdued growth in real disposable income and credit extension, tighter fiscal policy and low consumer confidence levels are expected to weigh on overall consumer spending, and hence GDP growth, over the festive season and beyond.

This report was completed on 4 December 2017.
Please refer to the glossary on the BER's website for explanations of technical terms.

Contents

Introduction

The 2017Q4 Retail Trade publication covers two surveys related to consumer spending, namely the FNB/BER Consumer Confidence Survey[1] and the BER Retail Survey. It presents a quarterly analysis of consumer expectations and activity in the retail, wholesale and motor trade sectors.

According to Statistics South Africa (Stats SA), growth in real consumer spending measured 1.1% year-on-year (y-o-y) in 2017H1 after posting growth of 0.8% in 2016. Over the same period, retail sales volume growth measured 1.9% versus the 1.7% recorded in 2016. While both retail volumes and overall real spending have improved somewhat year-to-date, growth remains well below long-run average levels. Additionally, what little real growth there has been was boosted by lower selling price inflation, suggesting that underlying consumer demand remains weak. Inflation as measured by the consumption deflator has moderated from 6% in 2016 to just 5.1% in 2017H1, while retail price inflation has slowed from 6.2% to 4.8%.

Tough trading conditions cloud consumer spending outlook

Unfortunately, according to the latest survey results, total retail sales volume growth (and real consumer spending growth in general) will likely remain subpar in 2017Q4. Retailer confidence dropped on the back of tough trading conditions, weak volume growth and deteriorating profitability. While business conditions improved somewhat in the durable goods category, both the semi-durable and non-durable goods retailers posted disappointing results. Confidence in the wholesale sector did improve, but the latest survey results highlight contrasting fortunes in the different wholesale categories with non-consumer goods in particular recording weak numbers. One positive from the survey results is the fact that new vehicle trader confidence ticked up. However, caution is warranted as underlying consumer demand remains weak.

In all, the 2017Q4 survey results suggest that conditions in the retail sector remain tough and volume growth likely slowed somewhat during the fourth quarter. At 1.9% y-o-y, the growth in total retail sales volumes for the first nine months remains well below the long-run average of around 4.5%. In fact, when excluding the fast growing "other" retail category, real retail sales expanded by only 1% year-to-date, highlighting the weak underlying demand environment. The consumer continues to face a number of headwinds, including low consumer confidence levels, lacklustre employment growth, tight credit conditions and less supportive fiscal policy. These factors will likely keep a lid on consumer spending growth over the coming 12 to 18 months.

[1] The 2017Q4 FNB/BER Consumer Confidence Index results will be published in January 2018.

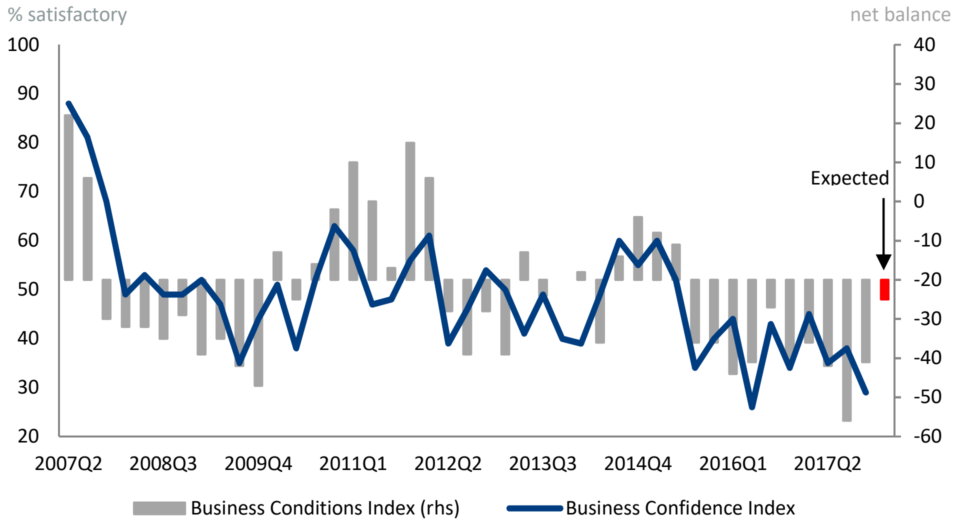
Summary of the 2017Q4 trade sector survey results

Retail confidence remains depressed on disappointing volumes, low profitability

Retailer confidence remains in the doldrums

According to the latest BER Retail Survey[2], business confidence among retailers fell sharply during 2017Q4. In all, only 29% of retailers reported being satisfied with prevailing business conditions in 2017Q4, down from 38% in the third quarter. Business conditions remain constrained, with a net majority[3] of 41% of retailers reporting that business conditions deteriorated relative to a year ago, while a net 32% reported lower sales volumes. The latest survey results are particularly disappointing given the seasonality inherent in the survey data – both confidence and sales volumes indices normally display a festive season bump that is not evident in the latest survey results.

Figure 1: Deterioration in retail confidence in 2017Q4



Source: BER

In contrast to the negative survey results, actual consumer spending has been surprising on the upside in recent months. According to Stats SA, retail volumes expanded by 4.1% y-o-y in 2017Q3 following a 2.2% expansion in Q2. However, much of this improvement can be attributed to the "other" retail category[4], which has been expanding at a breakneck pace in recent months. Much of the

[2] The fieldwork for the 2017Q4 survey was conducted between 16 October and 20 November 2017.

[3] A net majority indicates the percentage of respondents reporting an improvement in business conditions compared to the same quarter of the previous year less the percentage reporting a deterioration in business conditions.

[4] This category includes retailers in reading matter and stationery, jewellery, second-hand goods, and sport and entertainment goods, as well online retailers.

improvement in this category can be linked to sample changes in the Stats SA survey, implying that underlying consumer demand remains weak. When stripping out this category, retail volumes expanded by only 1% y-o-y in the nine months to September. Even when including the "other" category, overall retail sales growth remains well below the long-run average of 4.6% y-o-y.

Underlying demand environment remains weak

The underlying economic environment remains unsupportive of strong growth in consumer spending. While moderating inflationary pressures and the marginal cut in the policy interest rate will likely provide some relief to consumers, lacklustre private sector employment creation, weak credit growth and low consumer confidence levels should continue to weigh on retail volume growth (and consumer spending in general) going forward. Additionally, following significant tax increases in 2017, fiscal policy will be even less supportive of consumer spending in 2018 and beyond given the mounting pressure on government finances.

While volume growth could receive some support from increased festive season spending, not to mention the low base in 2016Q4 when volumes expanded by a meagre 0.6%, the latest survey results suggest that a meaningful acceleration is not on the cards for 2017Q4. Additionally, while the survey period does not cover the Black Friday sales event, there might be less of a boost to volume growth than expected given the fact that this event is also in the 2016 base.

Conditions unlikely to improve

Looking ahead, retailers are not overly optimistic that conditions will improve significantly as we head into 2018. In fact, according to the latest survey results, a net majority of 25% of retailers expects general business conditions to deteriorate in 2018Q1, while a net 22% expects lower sales volumes compared to a year ago.

We now proceed to a more detailed breakdown of the latest survey results per retail category.

Semi-durable and non-durable goods retailers struggle, durables recover

Semi-durable turnover under pressure as price inflation slows

According to Stats SA, volume growth in the **semi-durable** category (e.g. clothing, footwear, sporting equipment, CDs and toys) recovered somewhat during 2017Q3 after posting weak numbers in 2017H1 (see Table 1 on the next page). However, the acceleration in volume growth came at the expense of overall profitability, with price inflation in the category moderating to 2.7% in 2017Q3. Semi-durable price inflation slowed from a recent peak of 6.6% in December 2016 to just 2.2% in September 2017, resulting in turnover growth remaining under pressure – nominal sales growth measured just above 6% y-o-y in 2017Q3, well below the long-run average of close to 9%.

Table 1: Year-on-year percentage change in retail sales volumes

	2016Q4	2016	2017Q1	2017Q2	2017Q3
Total	**0.6%**	**1.7%**	**-0.7%**	**2.2%**	**4.1%**
Non-durable goods[1]	-0.2%	1.8%	0.3%	2.5%	1.9%
Durable goods[2]	1.2%	1.3%	-1.0%	-2.0%	2.6%
Semi-durable goods[3]	3.3%	2.2%	-5.9%	1.7%	3.3%

Source: Statistics South Africa, Retail Sales Statistics

[1]Non-durable goods retailers include general dealers, retailers in specialised food, beverages and tobacco, and retailers in pharmaceutical and medical goods, cosmetics and toiletries
[2] Durable goods retailers include retailers in household furniture, appliances and equipment, and retailers in hardware, paint and glass
[3] Semi-durable goods retailers include retailers in textiles, clothing, footwear and leather goods

Disconcertingly, there appears to be no let-up on the horizon for semi-durable goods retailers. In fact, the latest survey results point to a renewed deterioration in trading conditions during 2017Q4. A net majority of 79% of semi-durable goods retailers reported that general business conditions worsened, while a similar majority reported lower volumes relative to a year ago. This, combined with continued pressure on selling prices, resulted in the index measuring overall profitability dropping to its lowest level on record. While input costs have remained contained on the back of a resilient rand exchange rate and low global inflation, retailers seem unable to benefit as fierce competition and weak consumer demand is forcing semi-durable goods retailers to pass cost savings on to the consumer in the form of lower selling prices.

Low profitability, weak volume growth hit semi-durable confidence

The fact that semi-durable goods sales volumes deteriorated - despite highly competitive pricing - is concerning, with the resulting drop in profitability leading to a 21 index point fall in overall business confidence in the category in 2017Q4. In all, only 16% of semi-durable goods retailers are satisfied with prevailing business conditions. The latest survey results are close to the levels recorded in 2016Q3 when semi-durable volumes contracted by 0.4% as unseasonably warm weather weighed on clothing and footwear sales. The combination of the 2017Q4 survey results and the relatively solid base in 2016Q4 suggest that semi-durable goods volume growth could come under significant pressure in the final quarter of 2017.

Looking further ahead, tight credit conditions, low consumer confidence levels and additional fiscal consolidation in early-2018 should continue to weigh on volume growth in the category over coming quarters.

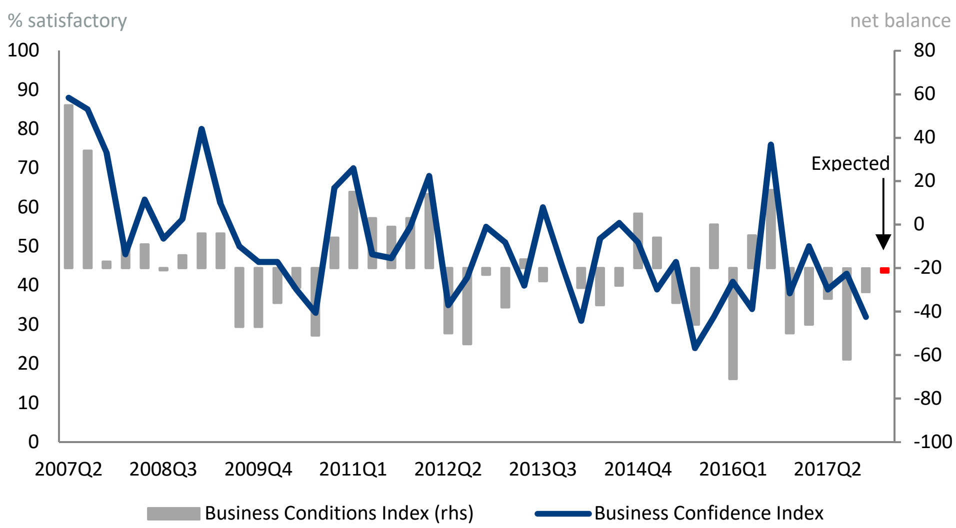
According to Stats SA, **non-durable** (e.g. food, beverages, groceries, pharmaceuticals and cosmetics) volumes remained relatively well-supported in 2017Q3 after recovering handsomely in Q2. After expanding by 2.5% y-o-y in

2017Q2, volume growth measured 1.9% during the third quarter (see Table 1). As was the case in 2017Q2, retailers of food, beverages and tobacco in specialised stores were the standout performers, with volume growth in the category measuring 5.7% y-o-y. Non-durable sales volume growth has been supported by moderating price inflation. Inflation as measured by the implicit retail price deflator slowed to 4.5% y-o-y in September 2017 from a recent peak of 9% in December 2016. Food price inflation has moderated sharply on the back of falling grain and cereal prices, while beverage and pharmaceutical product price inflation has remained contained.

Tough trading conditions in non-durable goods category

While non-durable goods sales volumes ticked up in mid-2017, growth remains well below long-run average levels and, according to the latest survey results, a significant improvement is not expected over the festive season. In all, only 32% of non-durable goods retailers reported being satisfied with prevailing business conditions in 2017Q4, while a net 31% indicated that conditions deteriorated relative to a year ago (see Figure 2 below). While retailers are cautiously optimistic that conditions will improve as we head into 2018, weak employment growth, subdued growth in government remuneration and social transfers, and significant tax increases (with more to come) will likely keep a lid on non-durable goods volume growth going forward.

Figure 2: Non-durable goods retailer confidence deteriorates



Source: BER

Higher volumes boost durable confidence

According to both the latest official data and the 2017Q4 survey results, **durable goods** (e.g. hardware, furniture and household appliances) retailers posted somewhat of a recovery in 2017H2 after several quarters of decline. Durable goods volume growth measured 2.6% y-o-y in 2017Q3, all but reversing the contraction recorded in the previous two quarters. Encouragingly, the latest survey results suggest that this recovery gathered some steam in 2017Q4. According to the survey results, 37% of durable goods retailers reported being satisfied with prevailing business (27% in 2017Q3), while a net 5% reported higher sales volumes relative to a year ago. This is the first time that the sales volumes index has been in positive territory since 2016Q1.

Furniture and appliances volume growth recovers handsomely

Volume growth is being boosted by a strong expansion in the household furniture, appliances and equipment category, which posted volume growth of 7.7% in the third quarter and looks set to continue along the recovery path in 2017Q4. Pent-up demand, lower prices and the normalisation of the credit market following the 2016 amendments to the National Credit Act seem to be supporting volume growth in the category. In stark contrast, conditions remain tough in the hardware and building material category. After contracting by 2.2% y-o-y in 2017H1, hardware and building material volumes remained flat in 2017Q3. The persistent weakness in the category likely reflects the continued struggles in the building and construction industry. A net majority of 51% of hardware and building material retailers reported worse trading conditions during 2017Q4 and a net 6% expects conditions to deteriorate even further in the first quarter of 2018.

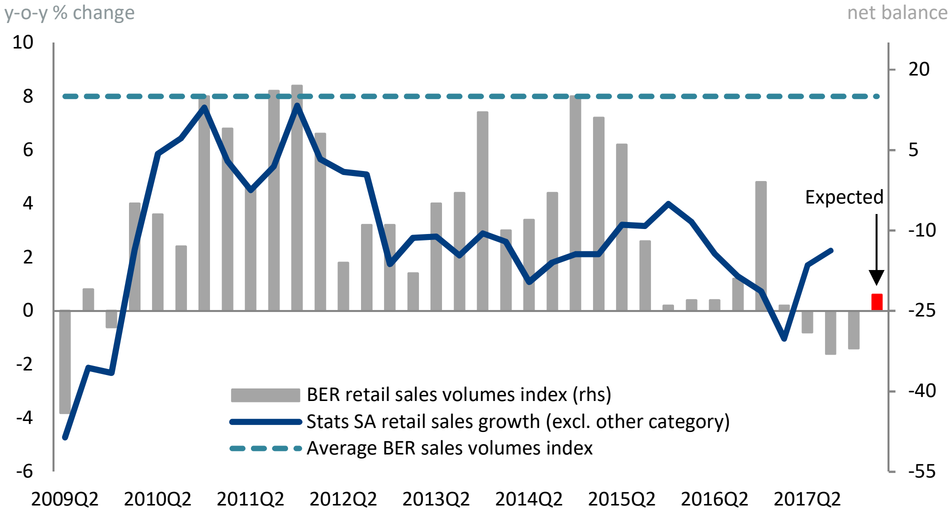
Durable retailers optimistic that recovery can be sustained

While the robust volume growth recorded in the durable goods category during 2017Q3 came at the expense of selling prices (prices inflation measured 0.6% y-o-y), it represents a marked departure from the lacklustre numbers recorded over the last couple of years. Encouragingly, the latest survey results suggest that volume growth remained well-supported during 2017Q4. Durable goods retailers are confident that conditions will continue to improve as we head into 2018, with a net 17% predicting higher sales volumes. That being said, tight credit standards and very low levels of business confidence (i.e. great uncertainty) will continue to weigh on credit extension, and hence volume growth, while the drag from tighter fiscal policy will limit consumers' spending power going forward. As such, any further recovery is likely to be hesitant and subdued.

Total retail volume growth remains subdued

Despite the relatively robust volume growth recorded in 2017Q3, the latest survey results suggest that trading conditions in the broader retail sector remain tough. In fact, when taking into account the distortion introduced by the sampling changes in the Stats SA survey, volume growth remains under pressure. What volume growth there has been has come at the expense of selling prices as weak demand has limited retailers' pricing power. In fact, total retail sector turnover growth measured just 7.7% in 2017Q3, well below the long-run average of around 10%. While volumes could receive some support from increased festive season spending and the low 2016Q4 base, the latest survey results suggest that growth could slow somewhat in 2017Q4 (see Figure 3 below).

Figure 3: Retail sales volumes set to slow



Source: BER, Statistics South Africa

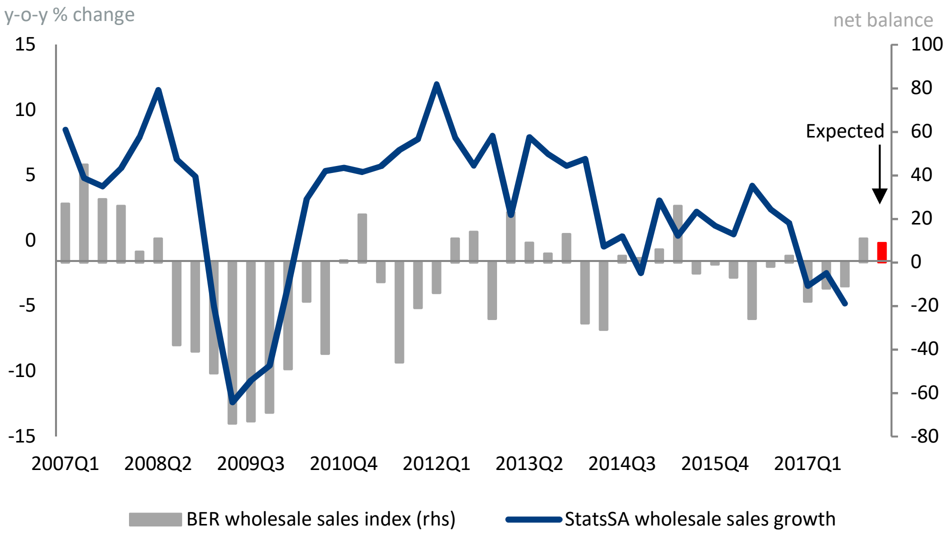
Wholesaler confidence ticks up as conditions improve

Wholesale confidence boosted by higher volumes

After expanding by 2.1% y-o-y in 2016, wholesale sales volumes contracted by an alarming 3.6% y-o-y in the first nine months of 2017, in line with previous survey results. Encouragingly, results from the latest survey suggest that, while conditions remain relatively tough, some improvement can be expected over the 2017 festive season. In all, a net majority of 11% of wholesalers reported higher volume growth relative to a year ago, the first positive reading since 2016Q4. While margins remained under pressure on the back of rising input costs, the higher volumes, combined with some pricing power, resulted in an improvement in overall profitability in the sector. This resulted in overall confidence ticking up. In all, 51% of wholesalers reported being satisfied with prevailing business conditions. The latest survey results suggest that wholesale volumes could post somewhat of a recovery during 2017Q4 (see Figure 4 on the next page).

Looking ahead, wholesalers expect conditions to continue to improve marginally as we head into 2018. While a net 18% of wholesalers expect trading conditions to remain tough in 2018Q1, a net 9% do expect sales volumes to tick up further from current levels.

Figure 4: Wholesales volume growth remains under pressure



Source: Statistics South Africa, BER

While wholesaler confidence ticked up marginally in 2017Q4, the overall results mask vastly different experiences in the different wholesale categories. Business confidence among wholesalers in the **consumer goods** category (e.g. textiles, clothing, footwear, food, beverages, furniture and household appliances) improved markedly. In all, 64% of consumer goods wholesalers reported being satisfied with present business conditions, up from 46% in 2017Q3. The surge in confidence was underpinned by higher sales volumes and improved margins, which led to a substantial improvement in overall profitability in the sector. Importantly, conditions improved across the entire consumer goods category, with both wholesalers in clothing and footwear and food and beverages recording solid numbers. The performance of consumer goods wholesalers stands in marked contrast to the experience of semi-durable and non-durable retailers in particular, suggesting that the consumer might be bypassing retailers and purchasing directly from wholesalers. Consumer goods wholesalers expect conditions to improve further in 2018Q1, with a net 14% projecting higher sales volumes.

Consumer goods wholesalers post strong numbers

In stark contrast to the experience of consumer goods wholesalers, business confidence among wholesalers in the **non-consumer goods** sector (e.g. machinery, building material, chemicals, petroleum products and office equipment) dipped sharply in Q4. In all, only 37% of non-consumer goods wholesalers reported being satisfied with current business conditions in 2017Q4, down from 50% in the third quarter.

The drop in confidence was the result of a significant deterioration in overall profitability in the sector. While sales volumes did tick up, the improvement came at the expense of selling prices as non-consumer goods wholesalers were forced to contain selling price inflation in the face of weak domestic demand.

Non-consumer goods wholesalers expect conditions to remain tough in 2018Q1, with a net majority of 27% expecting conditions to deteriorate in early 2018.

After falling sharply in 2017Q3, confidence among hardware and building material wholesalers remained at depressed levels in Q4. Only 9% of wholesalers in this category reported being satisfied with prevailing business conditions, with a net majority of 16% indicating that trading conditions deteriorated relative to a year ago. While residential building activity seems to be turning a corner, non-residential building and civil construction remain in the doldrums and the survey results for building and hardware wholesalers (and hardware retailers) suggest that overall activity remained under pressure in Q4. Disconcertingly, wholesalers do not expect conditions to improve going forward, with the subdued outlook for both private and public sector fixed investment projected to keep a lid on volume growth over the foreseeable future.

Non-consumer goods wholesalers struggling

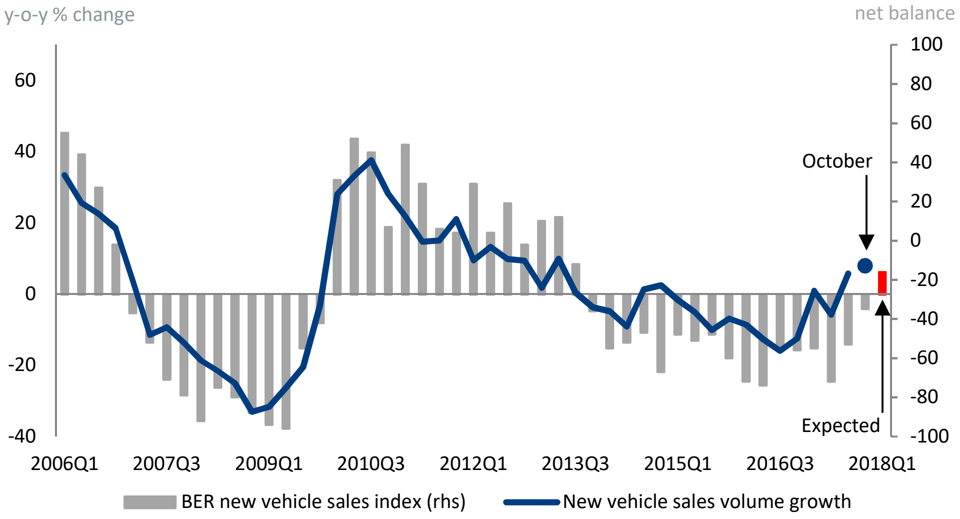
In contrast to the 2017Q3 survey results, machinery and equipment wholesalers also posted weaker results in Q4 on the back of subdued growth in mining and manufacturing activity. In all, 55% of wholesalers in this category reported being satisfied with prevailing business conditions (down from 65% in Q3), with a net majority of 18% reporting lower volumes. Looking further ahead, machinery and equipment wholesalers do not expect conditions to improve materially in 2018Q1. Mining and manufacturing activity remains subdued on the back of low business confidence levels and weak demand conditions, while the continued drought in the Western Cape threatens to derail the expansion in agricultural output.

New vehicle trader confidence on the mend

After contracting by 12.4% y-o-y in 2016 and by a further 2.1% in 2017H1, new passenger car sales expanded by a robust 5.8% y-o-y in 2017Q3. The latest survey results suggest that the recovery continued into 2017Q4. In fact, volumes expanded by 7.9% y-o-y in October (see Figure 8 below). Volume growth has been boosted by pent-up demand, increasingly attractive dealer incentives and, possibly, the end of the replacement cycle. However, as mentioned before, some caution is warranted. While encouraging, the improvement in volume growth does come off a very low base, with sales contracting by 15.9% in 2016Q3 and by 9.5% in October 2016. Additionally, the level of new passenger car sales recorded up to October 2017 is just 1.3% above that recorded over the same period in 2016 and measures 11% below total sales in the first ten months of 2015.

New vehicle sales growth continues along upward trend

Figure 5: Continued recovery in new passenger car sales



Source: dti, BER

Confidence remains subdued

As such, while sentiment improved further over the quarter, confidence levels remain subdued – only 32% of new vehicle traders reported being satisfied with current conditions during 2017Q4. While new vehicle traders expect conditions to improve further in 2018Q1, weak disposable income growth, subdued credit growth and low consumer confidence keep a lid on new passenger car sales going forward.

Used vehicle dealer confidence drops

In contrast, used vehicle sales growth slowed from 21.2% y-o-y in 2016 to just 4.3% in the first nine months of 2017, with volume growth measuring just 1% y-o-y in September. The latest survey results suggest that the slowdown continued into the fourth quarter, with a net 22% of used vehicle traders reporting lower volumes relative to a year ago while a net majority of 15% indicated that general trading conditions had worsened. This resulted in confidence dropping by 3 index points over the quarter, with only 34% of used vehicle traders satisfied with current business conditions. Used vehicle traders expect conditions to improve marginally going forward, but the recent slowdown in volume growth and the concomitant improvement in the new vehicle market has tempered expectations.

Concluding Remarks

The trade sector expanded by 0.6% q-o-q (annualised) in 2017Q2 after contracting by 5.9% q-o-q in the first quarter. While retail sales expanded by another 5% q-o-q (annualised) in 2017Q3, wholesale volumes contracted by over 10%, suggesting that the trade sector as a whole remains under pressure. Results from the latest BER Retail Survey do not inspire confidence in a meaningful acceleration during 2017Q4. Conditions remain tough in the retail sector, particularly for semi-durable and non-durable goods retailers, while the wholesale sector recorded mixed results, with non-consumer goods wholesalers continuing to struggle. Subdued volume growth, combined with an inability to pass cost increases on to consumers, resulted in a deterioration in overall profitability in both the retail and wholesale sectors. This weighed on overall business confidence during the quarter.

Despite the recent uptick in retail sales volume growth, the consumer environment remains weak. Subdued growth in real disposable income and credit extension, tighter fiscal policy and low consumer confidence levels are expected to weigh on overall consumer spending, and hence GDP growth, over the festive season and beyond.

Technical note

Short-term planning is hampered as numeric (official) data is released with a time lag. Business *survey results reveal what happened between the release of the last official figures and the current state of affairs*. The results not only reveal beforehand the direction of sales, selling prices, employment etc. (for which official figures are published), but also *provide unique information*, such as business confidence, rating of business conditions and respondents' expectations (or forecast) for the next quarter for which no official figures exist. It is now widely recognised that these subjective individual expectations play a key role in economic developments. Furthermore, the survey results of successive quarters *provide a means of tracking cyclical movements, pinpointing trend changes* and establishing forecasts.

The survey results are obtained from questionnaires completed by senior executives in the trade, manufacturing and building sector during the last month of every quarter. The business survey questionnaire contains a small number of questions. These questions are qualitative in nature, e.g. "Compared to the same quarter a year ago, are the volume of sales up, the same or down?" No figures are requested. The sample of executives remains the same from one survey to the next. A panel is in effect established. The sample is divided according to main sectoral categories. Each firm gets a weighting in relation to turnover or size of workforce to provide for widely differing sizes. Participants have to complete a "participant details form" every few years to ensure that they are correctly classified and to provide for changes in turnover. The list of participants is also reviewed every few years to ensure an agreeable representation of the universe.

Most of the responses are converted into net balances. For example, if the percentage of respondents rating sales volumes higher / the same / lower than a year ago is as follows;

Higher	Same	Lower
70	10	20

then we can conclude that the majority of participants experienced higher sales. A net majority (i.e. the percentage of respondents rating sales higher less the percentage rating sales lower) of 50% is registered in the above example. A net majority of –10% for example would have indicated a decline in sales volumes compared to a year ago. A value of zero therefore indicates no change, between 0 and 100 reflects a rise (or improvement) and between 0 and –100 a decline (or deterioration) compared to the same quarter a year ago.

The responses relating to business confidence are presented as percentages. For example, business confidence of 10 index points would indicate that 10% gross of the respondents rated prevailing business conditions as satisfactory. These data series vary between zero and 100. A value of zero reflects an extreme lack of confidence and 100 extreme confidence. Furthermore, respondents have to rate the present situation and not how it compares with that of the same quarter a year ago as in the case of the "net balance" questions.