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## **South African SMME Business Confidence Index Report: Fourth Quarter 2005**

Compiled by: Africagrowth Institute

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## **1. Introduction**

Very little is known about the impact and the actual size of Small Medium and Micro Enterprise sector (SMME) in the South African economy and yet the contribution that the sector makes in terms of creating job opportunities and contributing to GDP can not be overstated. The full potential of the sector is yet to be fully exploited. A host of stakeholders are limited in their ability to plan, do strategic forecasting and to design and formulate policies for this sector as a result of the non-availability of economic indicators derived from variables which are unique and specific to this sector. The SMME index is an important addition to current economic indicators that provide information about the SMME sector. It quantifies qualitative variables considered as key drivers in the economy. By focusing on the SMME sector, this index differs from similar surveys in that other surveys tend to focus mainly on large businesses. The SMME index measures the confidence of small, medium and micro businesses in the South African economy.

The construction of the SMME Business Confidence Index is a collaborative initiative by Africagrowth Research and the Africa Centre for Investment Analysis (ACIA) a research centre at the University of Stellenbosch. This research effort is also supported by the Small Enterprise Development Agency (SEDA) and Xtrata. This study also highlights and discusses the factors that enterprises in the various sectors of the economy consider to be the most important business constraints when conducting day-to-day business activities.

### **1.1. Background**

Economic growth in the South African economy is underpinned by the growth and expansion of the SMME sector. Measures that accurately capture and measure developments in this sector are therefore extremely important. A full understanding of this sector requires understanding all its driving forces which include both quantitative and qualitative factors. By measuring the degree of confidence in the small and medium business sector of the South African economy and measuring the attitudes and the economic expectations of small business owners throughout South Africa, this index complements and does not replace existing indicators. It serves as a useful forecasting tool to assist stakeholders make informed decisions and to develop strategic plans that will ensure success in the SMME sector. In addition, policymakers are provided with clearer insight about the future economic outlook of the country.

It is envisaged that the index will be used as a short term predictive indicator by Small Business Owners, Government, Researchers, Education and Training experts. The index will aid in the identification of the main issues and challenges affecting small business development in South Africa. In addition, the analysis of the present business situation as well as the future outlook will help generate and identify trends of changes in the economy. Useful comparisons with official statistical indicators that measure the business cycle can be made.

The Organisation for Economic Co-operation and Development (OECD) has set out guidelines for the variables to include in the questionnaire in order to accurately determine the confidence of business enterprises in the economy. These have been included in this survey to ensure the relevance and accuracy of the index.

## **1.2. Objectives**

The index will help develop a unique research base that will promote SMME development in South Africa and to also promote SMMEs as key drivers of economic growth. The specific objective includes constructing a confidence index that Small Business Owners, Central Governments, Provincial Administration, Investors, Researchers, Education and Training experts can use to:

- Identify and take note of the main issues affecting small business development.
- Provide best practice examples to other SMMEs.
- Do small business trend analysis.
- Formulate policies that will enhance success of this sector in the economy.
- Identify investment areas.

This research hopes to contribute to the improvement of policy formulation, business management and investment decision making by providing information that is timely and relevant in terms of identifying constraints to doing business in the SMME sector as well as predicting the likely movement of changes in the economy in the future.

## **2. Methodology**

### **2.1. Data collection**

Questionnaires were sent to senior managers and owners of enterprises in the SMME sector. The number of employees was used for the classifications. The senior managers or owners were asked to indicate the 5 most important factors limiting business success in their organisations. They were also requested to give their views about the current economic situation compared to the previous three months as well as to give their expectations for the business situation in the next 6 months. The questionnaires were faxed and emailed to enterprises operating in 10 economic sectors (manufacturing, electricity, gas and water, construction, mining & quarrying and agriculture, whole sale trade, retail trade, financial & business services, transport storage and communication, catering and accommodation and community, social personal).

To be included in the sample, an enterprise needed to have either a fax number or an email address. The sample was drawn from a database of 17, 000 SMMEs in South Africa. This was a consolidation of databases from various sources. 5758 of the enterprises in the database came from a database received from the Department of Trade and Industry (DTI). The Western Cape Chamber of Commerce and Industry and Nafcoc JCCI also made their membership databases of enterprises which employ less than 250 people available. The Economic Development and Tourism Database for the Western Cape also formed part of the database. From the North West and Northern Cape provinces, Invest North West and the Kimberly Business Service Centre databases were received. From Mpumalanga, enterprises registered with Mpumalanga Provincial SMME were included. Client and service providers of the EDS were also incorporated into the database. Contact details were also sourced from the Telkom Yellow pages and the Brabys website.

Various SMME support institutions and service providers and agencies in the SMME sector were requested to dispatch the questionnaire to their clients and members. The web link to the online survey was placed and advertised on several websites including the SEDA website.

Three options to complete and return the questionnaire were given to sample units:

- 1) To go to [www.africagrowth.com](http://www.africagrowth.com) and to complete the questionnaire online
- 2) To print and fax back an emailed copy of the questionnaire
- 3) To complete and fax back a faxed copy of the email

Since the start of the survey, 213 telephone phone calls, 5000 e-mails and 1700 faxes were made.

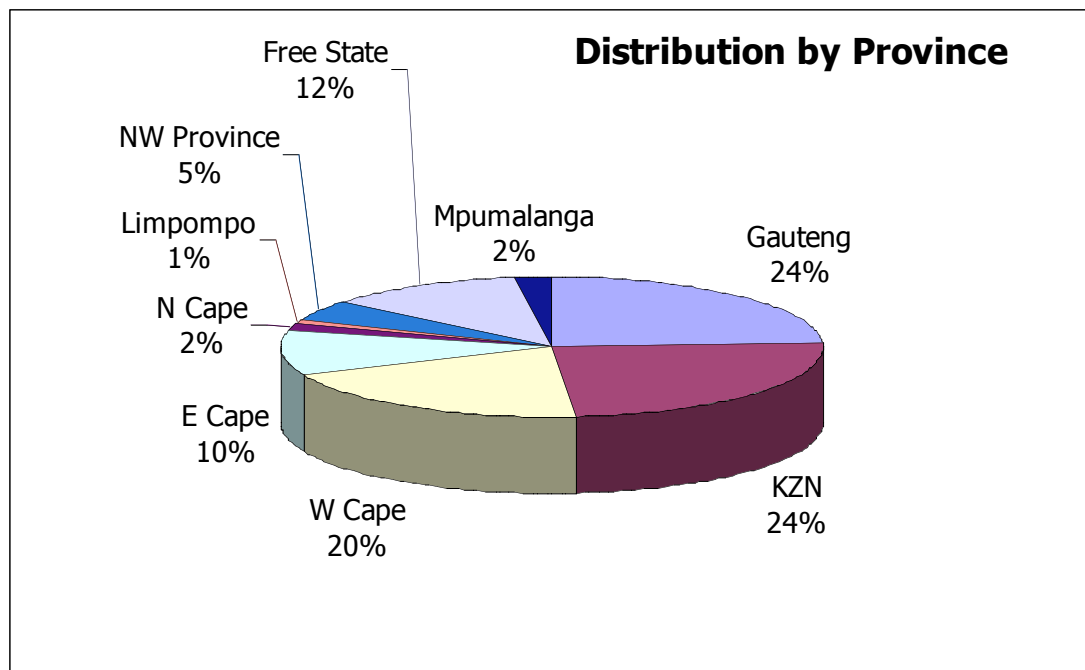
### 3. Survey Results

#### 3.1. Demographics

This section of the report looks at the demographics of the 225 enterprises that completed and returned the questionnaires. Summaries are given in terms of the distribution of the responses by province, size of the organisation as determined by the number of people employed, and annual turnover and by economic sector.

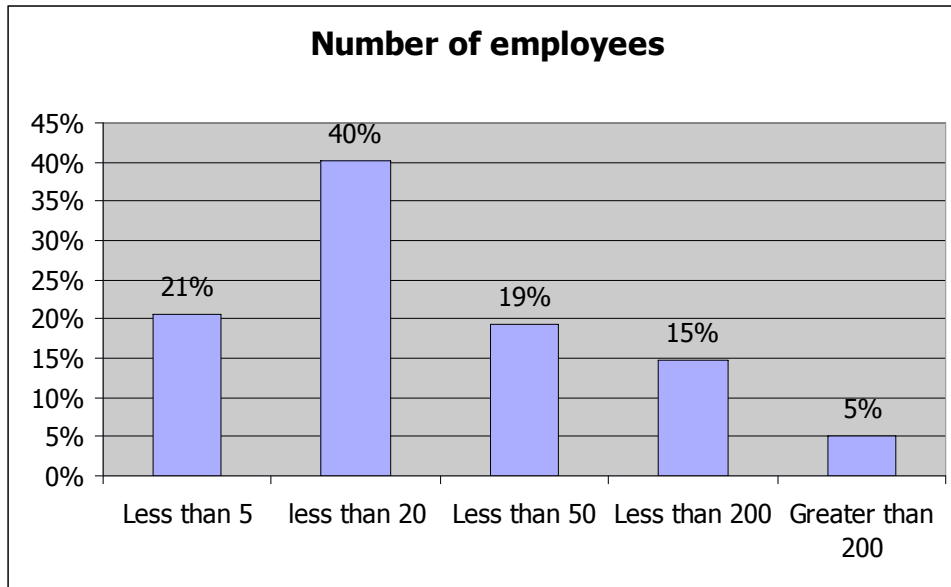
##### 3.1.1. Name of province

Of the 225 questionnaires received, Gauteng, KwaZulu Natal (KZN) and the Western Cape accounted for 68.3% of the total. Gauteng and KZN had 54 and 55 respectively. The Western Cape had 19.6% of the total. Limpompo, Northern Cape and Mpumalanga were the only three provinces where less that 10 questionnaires were received.



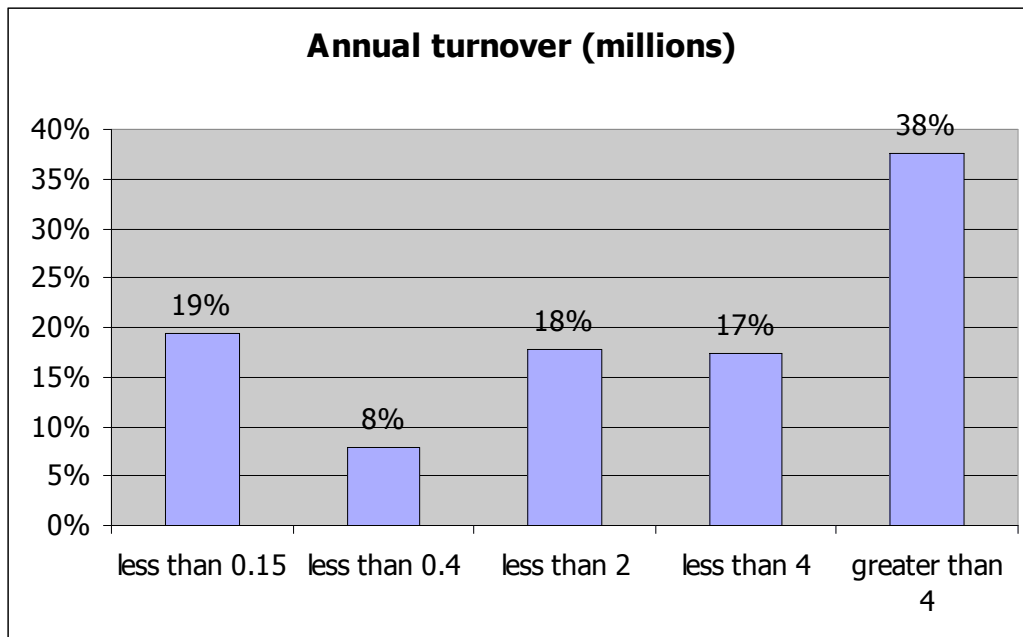
##### 3.1.2. Number of employees

80.2% of the 225 SMMEs that completed the questionnaire indicated that they employ fewer than 50 employees. The majority of the reporting units (40.1%) employ more than five but less than 20 employees. Only 5.1% of the enterprises employed more than 200 employees.



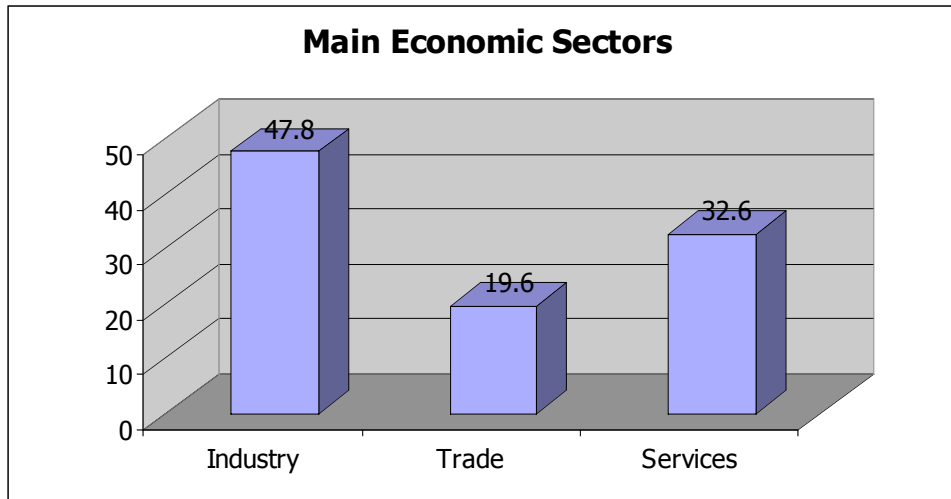
### 3.1.3. Annual turnover

37.6% of the reporting units make an annual turnover of more than 4 million. The smallest number of units (7.9%) makes an annual turnover that is between R400, 000 and R2 million. 17.3% of the units which took part in the survey make an annual turnover of less than R4 million.



### 3.1.4. Main economic sector

The Industry and the Trade sectors together account for 67.4% of the enterprises that took part in the survey. The largest concentration of enterprises (47.8%) was in the industry sector followed by the services sector which had (32.6%) of the total.



#### 3.1.4.1. Industry sub-sectors

There are 107 enterprises in the industry sector. Manufacturing, construction, mining & quarrying constitute the industry sector. The largest number of the reporting units is in manufacturing. They constitute 82.25% of the total.

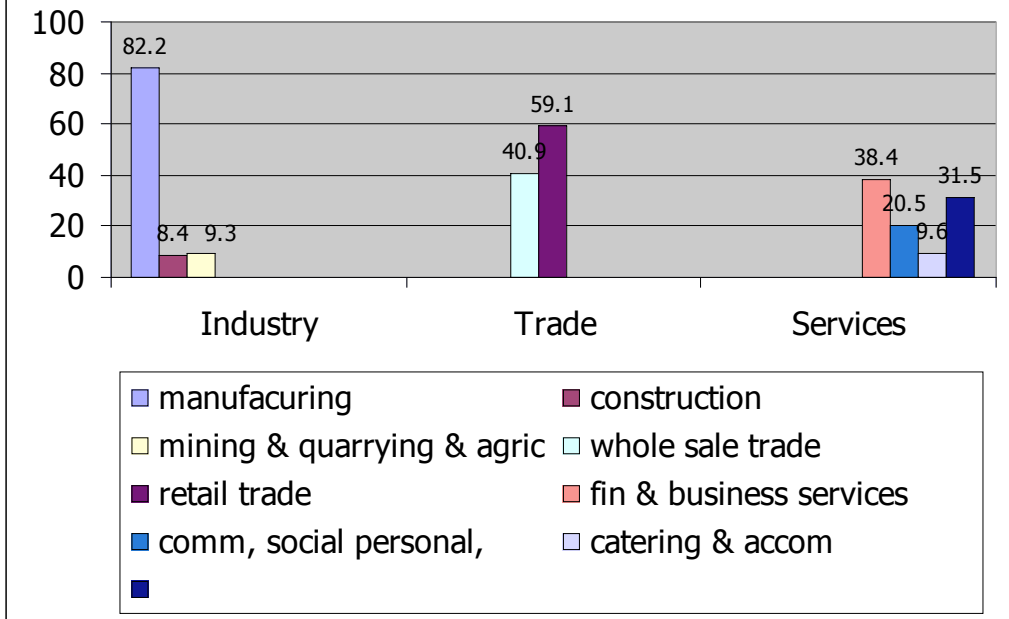
#### 3.1.4.2. Trade sub-sectors

The trade sector is made up of two sub-sectors, whole trade and retail trade sub-sectors. Only 44 of the 225 that completed the questionnaire fall within trade sector. The retail trade sub-sector at 59.1% has the largest number of the enterprises in the trade sector.

#### 3.1.4.3. Services sub-sectors

38.4% of the enterprises in the services sector fall within the Financial and Business services sub sector. Catering and accommodation is the second largest sub-sector with 31.5% of the total number of units.

## Sub-sectors



### 3.2. Present and Future Situation- Trade Sector

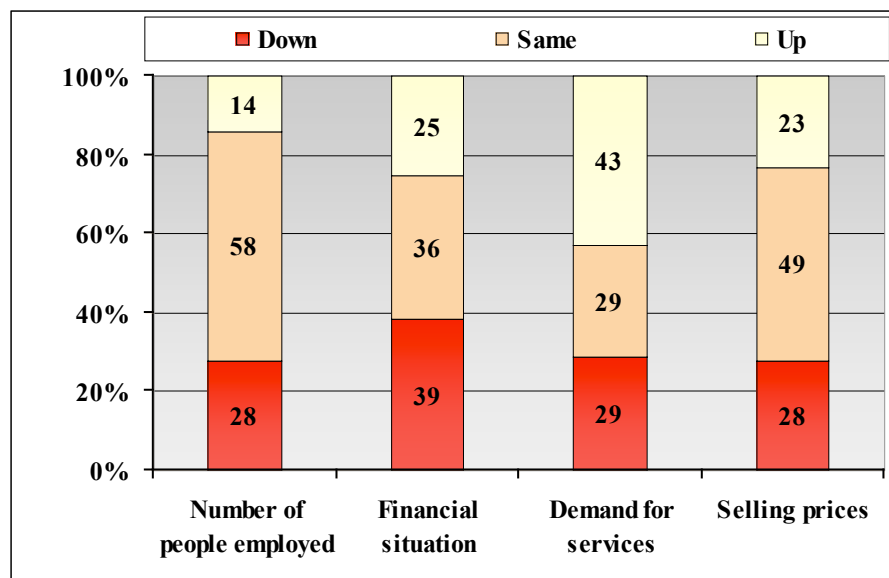
This section of the report discusses SMME business perception of the present state of the economy and their outlook for the next 6 months. The responses presented represent the views of SMME engaged in trade related activities. The number of businesses that responded to this section of the questionnaire numbered 225.

#### 3.2.1 Perception about present state of economy

*Employment* – The majority (58%) of the business managers and owners said their employment levels have remained fairly the same over the past three months. However, 14% indicated that they had created new positions whilst 28% stated that their employment levels have relatively gone down over the period. See figure below.

*Financial situation* - One out of four (25%) indicated that their financial situation has improved on the other hand almost twice as much (39%) they were worse off. Another 36% suggested that their lot has neither improved nor worsened.

Figure 1. Business perception about present state of economy



#### *Demand for services* -

Most of the businesses were very upbeat about the demand for services now as compared to the past three months. The proportion of the businesses that pointed out that the level of demand for their services have remained the same were as much as those who thought the demand for the goods have somewhat gone down.

#### *Selling prices* –

Nearly half of the businesses (49%) said their selling prices have remained unchanged over the past three months whilst 28% indicated that prices have rather gone down. Only 23% asserted that they had recorded increases in the prices at which their goods were sold.

#### 3.2.2. Future outlook

##### *Employment*

Most businesses (57%) in trading do not see the possibility of creating new jobs in the next six months. On the contrary 27% of the respondents claimed they were pretty sure that additional jobs would be created in their establishments in the next six months. Another 16% appeared pessimistic and felt that their employment levels may drop in the next half-year.

**Financial situation**

A fairly good number of businesses (39%) noted that they expected their financial situation to improve in the next six months. A slightly higher number (43%) did not anticipate any change in their financial situation whilst 18% appeared downbeat and expected their lot to worsen.

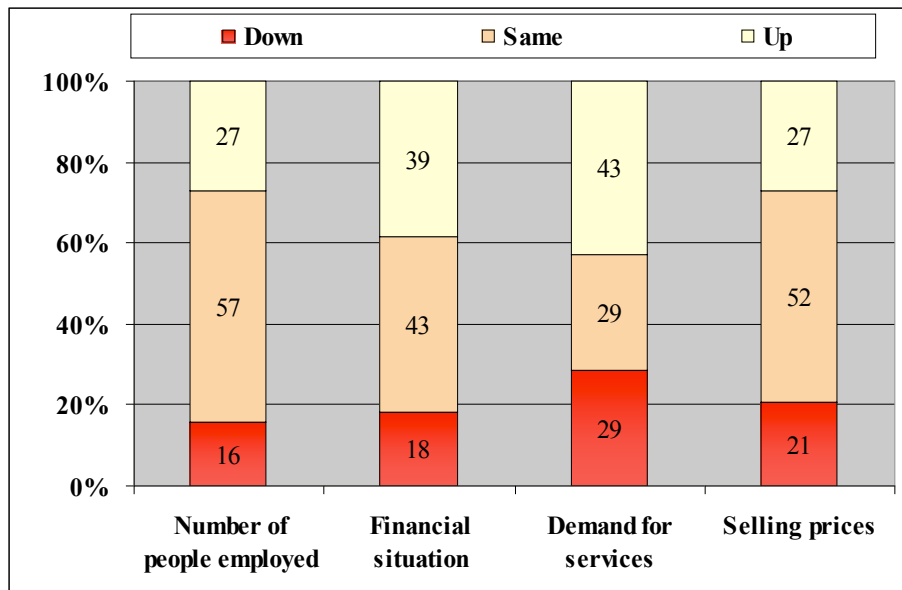
**Demand for services**

The strong demand for the products of SMMEs in trade is expected to continue for the next six months. Outlook for demand for services appeared to be as strong as the perception about current levels of demand (i.e. 43% see previous section). Only 18% thought demand was going to go down in the next six months.

**Selling Prices**

Selling prices are mostly expected to remain unchanged in the future. Twenty seven percent (27%) on the other hand said they were going to put up their selling prices in the next six months. Again, one out of five (21%) indicated that the prices of their products would rather fall in the next 6 months.

Figure 2. Business outlook about the economy in the next 6 months



### **3.3. Present and Future Situation- Services Sector**

In looking at the business situation with reference to the past three months, firms in the services sector indicated their opinion on a four-variable point scale; namely number of people employed, the financial situation, volume of demand and stock levels over a 9-month period (3 before and 6 after).

#### **3.3.1 Perception about present state of economy**

##### **Employment levels:**

Out of the 71 respondents, majority of them (46) representing 64.8% indicated that their employee levels have remained the same. 17 (23%) of the respondents indicated that employment levels have gone up over the past 3 months. 8 out of the 71 indicated that they had experienced a reduction in employment level over the past 3 months.

##### **Financial situation:**

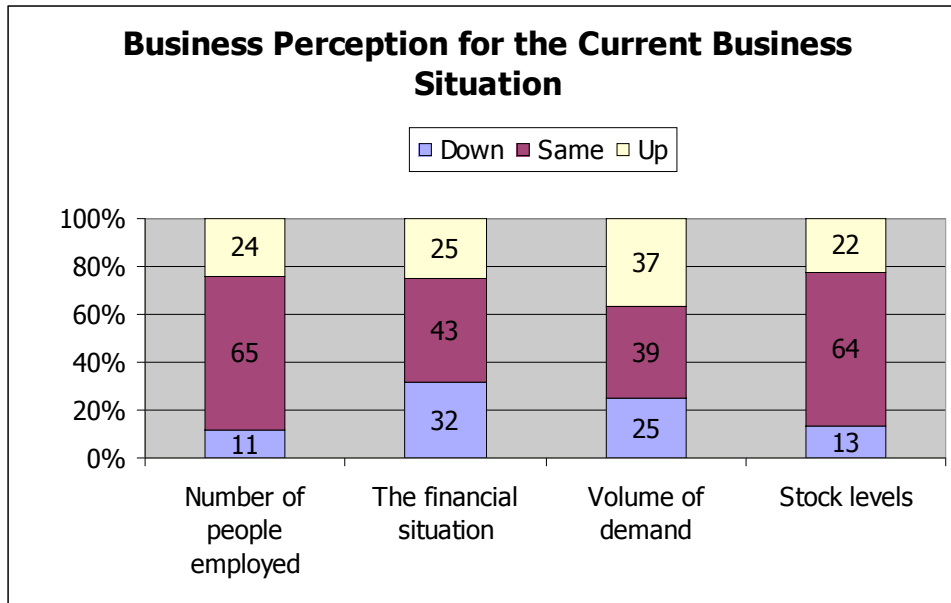
Out of 72 respondents, 43.1% (31) pointed out that their financial position has remained the same over the past 3 months. Also, 18 firms said their financial position improved over the last three months and 23 of 72 (31.9%) experienced declining financial fortunes.

##### **Volume of demand:**

With regards to marketing activities in terms of volume of demand, there has been somewhat a mild activity level over the past three months. While 25 (43.1%) of the 65 respondents said there has been no change over the past 3 months, 24 respondents, representing 36.9% indicated that demand volumes have gone up and 24.6% said demand volumes have rather declined over the past three years.

##### **Stock levels:**

Indeed, the stock levels which also represent the volume of activity further strengthen the low activity picture. This is because out of 45 respondents, 29 representing 64.4% said that stock levels have remained the same. 13.3% (6) indicated a decline in stocks reflecting low sales levels, and 22.2% (10) mentioned that their stock levels have actually gone up over the past 3 months.



### 3.3.2. Future outlook

#### Employment

28 of the 46 representing 40.6% revealed that employment levels will increase in the next 6 months. Again, out of 69 respondents, 52.2% stressed that employment levels will remain the same for the next 6 months suggesting that firms in the services sector seem not to alter employment level frequently. This may also be due to the presence of inertia in the sector. Only 5 out of the 46 painted a gloomy picture regarding employment levels over the next 6 months.

It must be indicated that in as much as these firms do not employ frequently, they also lay off workers at a lingering rate shown by the low percentages over a nine month period.

#### Financial situation

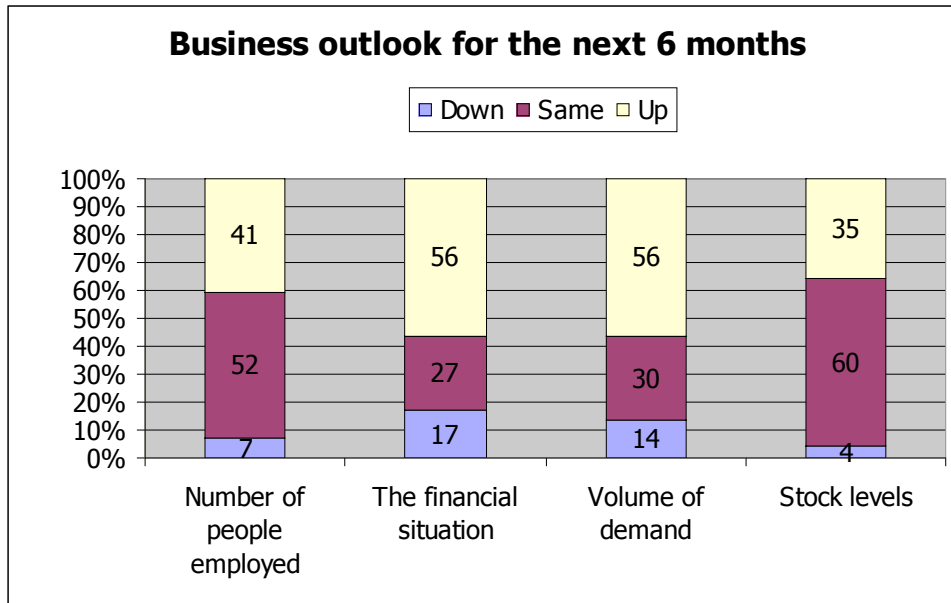
Looking into the future however, 56.3% (40) of the 71 respondents are hopeful that their financial positions will improve in the next 6 months. Comparing with present situation, about 16.9% (12) of 72 showing a fall of about 14 percentage points expect an unfavourable financial situation in the next six months. The picture is that a hopeful sector in terms of financial fortunes.

#### Volume of demand

On the future, while 30.3% (20) of the 66 respondents believe that the volume of demand is not likely to improve, 56.1% (37) of the firms in the services sector rather believe that demand volumes are likely to move up in the next 6 months, with just 9 firms representing 13.6% expecting a declining activity level in the next 6 months.

#### Stock level

In looking into the future, 29 (60.4%) out of the 48 respondents expect stock levels to remain the same over the next 6 months. While, 17 respondents, representing 35.4% expect stock to rise, only 2 (4.2%) of the respondents think stock levels will decline in the next 6 months. The economic environment portrayed is one of high degree of inertia.



### 3.4. Present and Future Situation- Industry Sector

#### 3.4.1 Perception about present state of economy

##### Employment levels:

With respect to number of employees, 23 representing 21.7% of the valid respondents of 106 reported that number of people employed during the last three months went down, 58 (54.7%) said employment remained the same for that period and 23.5% said employment increased.

##### Financial situation

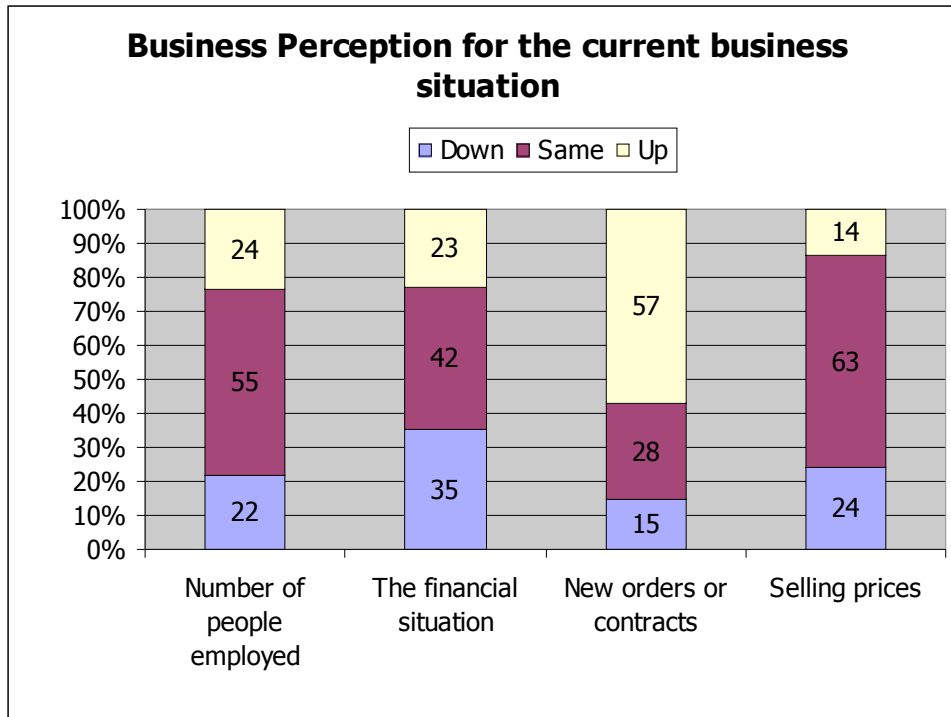
In terms of the financial situation 35.2% of 120 valid respondents complained of low financial performance during the last three months, 41.9% said their financial situation neither went down nor moved up, while 22.9% reported of upward performance in their financial situation.

##### New orders

New order went down for 15 (14.7%) of our 102 valid respondents. About twenty nine representing 28.4% of valid respondents experienced no change in terms of new orders while 56.9% said they had increase in new orders.

##### Selling prices

Selling prices dipped for 24% of our 104 valid respondents. Prices remained the same for 62.5% of the valid respondents and the remaining 13.5% reported that prices went up during the past three month period.



### 3.4.2. Future outlook

#### Employment levels:

With respect to future outlook, 11.4% of valid respondents of 105 expect a fall in the number of people employed. About fifty nine representing 56.2% of valid respondents forecast that number of people employed will remain the same but 32.4% anticipate an increase in the numbers in term of people employed.

#### Financial situation

In terms of the financial situation, 14.2% of the 106 valid respondents reported that they anticipate a fall in the financial situation, 37.7% said financial situation will remain the same while the remaining 48.1% said they expect an improvement in the financial situation of the firm.

#### New orders

About fifteen firms representing 14.7% of the valid respondents of 102 expected new orders to fall, 57.3% expect new orders to remain the same while the remaining 28.2% are hopeful of an increase in new orders.

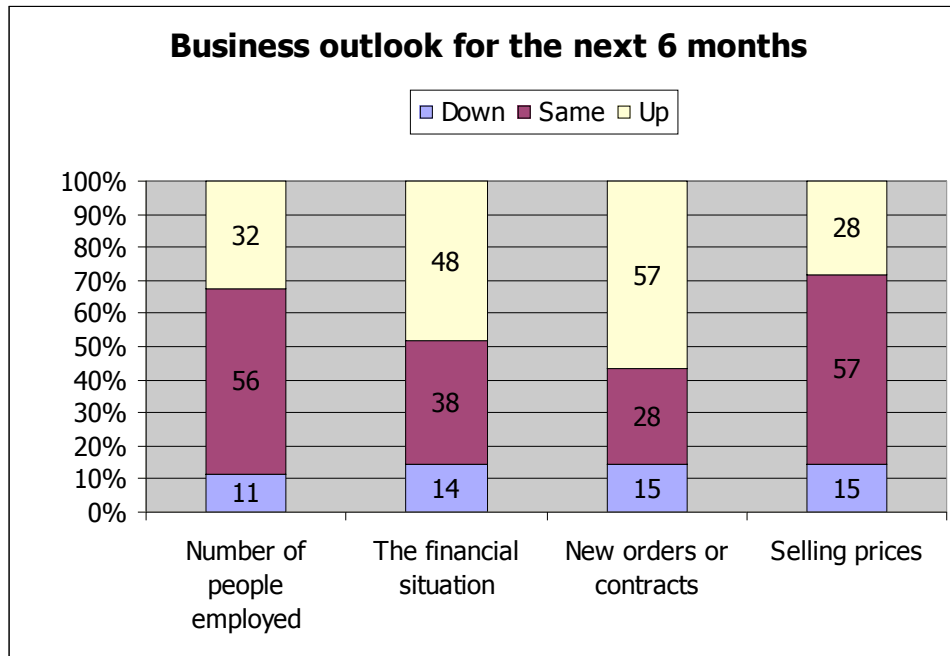
#### Selling prices

It is expected that, selling prices will remain the same in the next six months given that majority (57.3%) of the valid respondents anticipate so. About 29 representing 28.2% of valid respondent project increase in selling prices while 14.6% think selling prices will fall.

#### Stock levels:

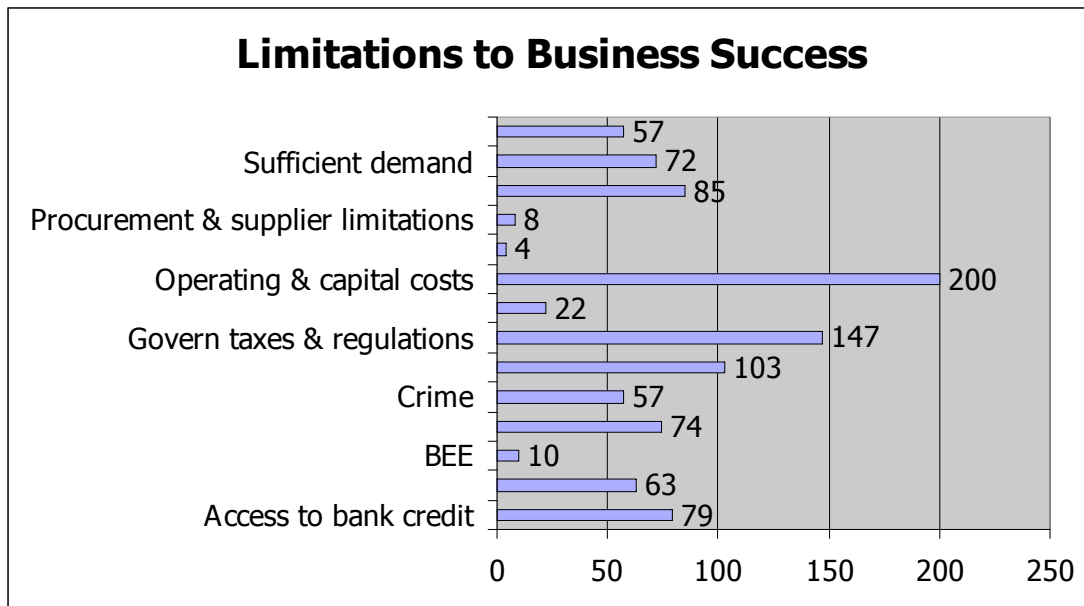
Indeed, the stock levels which also represent the volume of activity further strengthen the low activity picture. This is because out of 45 respondents, 29 representing 64.4% said that stock levels have remained the same. 13.3% (6) indicated a decline in stocks reflecting low sales levels, and 22.2% (10) mentioned that their stock levels have actually gone up over the past 3 months.

In a similar vein, 29 (60.4%) out of the 48 respondents said they expect stock levels to remain the same over the next 6 months. While, 17 respondents, representing 35.4% expect stock to rise, only 2 (4.2%) of the respondents think stock levels will decline in the next 6 months.



### 3.5. Limiting Factor Analysis

Operating & capital costs were considered the most important limiting factors by the majority of units which took part in the survey. This emerged as the most frequently cited limiting factor in all the three main sectors. It was the only factor selected by more than 80% of the units in all the main sectors. Government regulations and taxes were also high on the list of most of the reporting units. This was especially the case in the services sector where 72.9% of the units deemed this to be an important limiting factor. Employee costs are viewed as a limiting factor more in the trade sector than in Industry or services. The services sector regarded competition from imports less as a limiting factor than the units in industry and trade. Only 10% of units in this sector viewed this as an important limiting factor in comparison with 43% of units in Industry and 47.7% of those in trade. A higher percentage of enterprises in the services sector view crime as a limiting factor than those in industry or trade. Bee is considered by a higher percentage of units to be limiting in the trade sector.



### 3.6. The SMME Business Confidence Indices

#### 3.6.1. Methodology

There are 2 common methods of constructing business confidence indexes, Net Balances and Diffusion Indexes. The Diffusion Indexes range from 0 to 100 whilst Net Balances range from -100 to 100. Both methods essentially have the same information content and move in the same direction when plotted over time. The SMME Index was constructed using the Diffusion Index method. The index is computed as:

$$DI = 100(U + S / 2)$$

$DI$  = Diffusion Index

$U$  = Fraction of (Up) responses to questions in the survey

$S$  = Fraction of (Same) responses to questions in the survey

Though the reporting units (firms) within the sample come from a homogenous group of SMMEs there are nonetheless differences in the sizes. The difference in sizes is captured by the number of employees in each firm. In this regard responses from larger firms would carry more weight than that of smaller firms. A size weight is therefore computed and used to weight the responses.

$$DI_w = \sum^s (DI \times w_s)$$

$DI_w$  = Weighted Diffusion Index

$w_s$  = Size weights based on the number of employees in each firm, thus the larger the number of employees in a particular firm the larger the weight for that firm.

A composite confidence indicator which measures the general assessment of present economic conditions and future expectations is also computed. For each question and industry an index is computed for both the present and future business situation. For

instance for the Present business situation compared to the last 3 months the indices are computed as follows:

**Industrial Confidence Index:**

1. Q3a1: The number of people employed ( $DI_{a1}$ )
2. Q3a2: Financial Situation ( $DI_{a2}$ )
3. Q3a3: New Orders or contracts ( $DI_{a3}$ )
4. Q3a4: Selling prices ( $DI_{a4}$ )

Q3a1-Q3a4 are questions relating to Section 3a in the survey  
( $DI_{a1}$ ) - ( $DI_{a4}$ ) are indices for each question

The Industrial Confidence Index ( $ICI$ ) is given as:

$$ICI = (DI_{a1} + DI_{a2} + DI_{a3} + DI_{a4}) / 4$$

**Trade Confidence Index:**

1. Q3b1: The number of people employed ( $DI_{b1}$ )
2. Q3b2: Financial Situation ( $DI_{b2}$ )
3. Q3b3: New Orders or contracts ( $DI_{b3}$ )
4. Q3b4: Selling prices ( $DI_{b4}$ )

Q3b1-Q3b4 are questions relating to Section 3b in the survey  
( $DI_{b1}$ ) - ( $DI_{b4}$ ) are indices for each question

The Trade Confidence Index ( $TCI$ ) is given as:

$$TCI = (DI_{b1} + DI_{b2} + DI_{b3} + DI_{b4}) / 4$$

**Services Confidence Index**

1. Q3c1: The number of people employed ( $DI_{c1}$ )
2. Q3c2: Financial Situation ( $DI_{c2}$ )
3. Q3c3: New Orders or contracts ( $DI_{c3}$ )
4. Q3c4: Selling prices ( $DI_{c4}$ )

Q3c1-Q3c4 are questions relating to Section 3c in the survey  
( $DI_{c1}$ ) - ( $DI_{c4}$ ) are indices for each question

The Services Confidence Index ( $SCI$ ) =

$$SCI = (DI_{c1} + DI_{c2} + DI_{c3} + DI_{c4}) / 4$$

The overall index for the present business situation compared to the last 3 months ( $OIp$ ) is given as  $OIp = (ICI + TCI + SCI) / 3$

The same methodology as above is followed for the future outlook questions to obtain the overall index for the future business outlook in the next 6 months (*Olf*). The Overall SMME Confidence Index (*OSI*) is the average of the present and future indices.

Since the survey is the first of the series, these indices represent the base, and subsequent indices will be compared to these indices over time for time series analysis of SMME business confidence.

### **3.6.2. The SMME Business Confidence Indices**

#### **Aggregated Indices**

The industrial sector recorded the highest index of 30.8<sup>1</sup> followed by the Trade sector with 16.38 and the Services sector 9.09. The index for the Present conditions was 15.57 and that of the Future Outlook 21.94. Thus there is higher optimism amongst respondents in terms of the future business situations. The overall index was 18.76.

#### **The Disaggregated Confidence Indices for Present situation**

The indices computed are reported in Tables 1, 2 and 3 in the appendix. The industrial sector had the highest index (27.8) for present business situation followed by Services (19.20) and Trade (8.85). Indeed for all questions asked, the industrial sector had the highest index. The overall index for the present situation was 15.57. For each question asked, the highest index for the industrial sector related to the question on new orders and contracts (q3a3). Whilst in the Services sector the highest index was recorded for the question relating to the number of people employed.

#### **The Disaggregated Confidence Indices for Future situation**

The indices for the Future outlook follow a similar trend as the Present in terms of ranking by sector. The industrial sector had the highest index (33.63), followed by Services (20.89) and Trade (11.3). In terms of the indices for the various questions the question on new orders and contracts again scored the highest index for the Industrial sector. The overall index, an average of the present and future indices yielded 21.94. This is the base by which subsequent indices will be compared in a time series analysis.

#### **Present versus Future**

An interesting picture emerges when analysing the indices in terms of percentage change from Present to Future. The percentage change in the various sectors show 76% increase for Services, 64% increase for Industry and 20% increase for Trade. The percentage changes indices indicate that the Services sector is more optimistic about future business outlook. Based on changes in the question related indices, the Industrial and Trade sectors do not see any change in the future with respect to new orders and contracts. There are higher expectations for changes in the future outlook for all questions in the Services sector. The most remarkable expectation in the Services sector is the issue of financial situation (q3c3 and q4c3). The index for financial situation in the present increased from 0.12 to 22.50 in the future, thus showing that this sector expects very good improvements in the financial situation. Again in the Trade sector, the index for selling prices increased from 0.10 for the present situation (q3b3) to 11.35 for the future situation. This shows that there are greater expectations in this sector of higher prices in the future.

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<sup>1</sup> Note that the index ranges from 0 to 100

## *5. Conclusions and Recommendations*

List of Tables (1<sup>st</sup> Survey)

**Table 1 Question Specific Business Confidence Indices by Sector**

<b>PRESENT</b>					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
<i>q3a1</i>	58.46	<i>q3b1</i>	45.25	<i>q3c1</i>	59.18
<i>q3a2</i>	49.63	<i>q3b2</i>	46.59	<i>q3c2</i>	50.19
<i>q3a3</i>	77.85	<i>q3b3</i>	48.37	<i>q3c3</i>	54.12
<i>q3a4</i>	49.27	<i>q3b4</i>	50.25	<i>q3c4</i>	36.57
<b>Index (present)</b>	<b>58.8</b>		<b>47.61</b>		<b>50.01</b>
<b>Overall Present Condition Index</b>					
<b>52.14</b>					
<b>FUTURE</b>					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
<i>q4a1</i>	67.83	<i>q4b1</i>	59.73	<i>q4c1</i>	67.87
<i>q4a2</i>	75.48	<i>q4b2</i>	65.06	<i>q4c2</i>	73.47
<i>q4a3</i>	77.85	<i>q4b3</i>	48.37	<i>q4c3</i>	69.35
<i>q4a4</i>	61.69	<i>q4b4</i>	58.04	<i>q4c4</i>	46.89
<b>Index (future)</b>	<b>70.71</b>		<b>57.80</b>		<b>64.39</b>
<b>Overall Future Outlook Index</b>					
<b>64.30</b>					
<b>Overall Index (present and future)</b>					
<b>58.22</b>					
	<u>Industry</u>		<u>Trade</u>		<u>Services</u>
<b>%change present to future</b>	<b>11.91%</b>		<b>10.43%</b>		<b>14.38%</b>
<b>Overall Index %change present to future</b>	<b>18.91%</b>				

*q3a1-q3a4* are questions relating to Section 3a in the survey *q3b1-q3b4* are questions relating to Section 3b in the survey *q3c1-q3c4* are questions relating to Section 3c in the survey *q4a1-q4a4* are questions relating to Section 4a in the survey *q4b1-q4b4* are questions relating to Section 4b in the survey *q4c1-q4c4* are questions relating to Section 4c in the survey

**Table 2 Business Confidence Indices for Present and Past Outlooks by Sector**

Industry Confidence Index Present	Industry Confidence Index Future	Services Confidence Index Present	Services Confidence Index Future	Trade Confidence Index Present	Trade Confidence Index Future
58.8	70.71	50.01	64.39	47.61	58.04

**Table 3 Overall Business Confidence Indices**

Industry Index	64.75
Services Index	57.20
Trade Index	52.85

Present conditions Index	52.14
Future outlook Index	64.30
Overall Index	58.22