

Build Trends

March 2010 | Issue 115



**SARB
unexpectedly
cuts interest
rates**



Business confidence returns to pre-crisis levels



Consumer spending increases for the first time in six quarters



Value of building plans passed declined by 17.4% year-on-year in Jan-10

Macro-economic trends impacting on construction industry

The South African Reserve Bank unexpectedly cut its repo rate by 50 basis points to 6,5% to help accelerate a recovery from last year's recession and as inflation slows. This move adds to the 5 percentage points of reductions made between December 2008 and August 2009 to boost growth after weak local and global demand hit the key manufacturing and mining sectors.

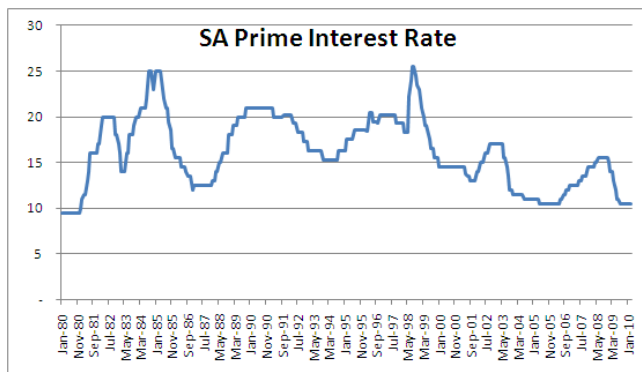
"If we looked at the demand side of the economy it is still improving, but very slow, it poses no upside risk to the inflation outlook as far as we see," Reserve Bank Governor Gill Marcus told a news conference. Interest rates are now at their lowest levels in more than 30 years and should

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the Rand strengthen further, there is even a chance of a further rate cut in coming months.

However, by cutting interest rates now, the Bank is setting itself up for a possible sharper upward move in interest rates if and when the environment for such a situation arises in due course.

The critical issue with regard to projecting interest rates ahead is the possibility of a marked deterioration in global financial sentiment at some stage which might spark a massive reversal of the extraordinary portfolio inflows which the country is currently enjoying. Such a situation could see the Rand weakening fairly dramatically and in so doing altering the inflation and interest rates scenario equally dramatically. From a real economic perspective, one should not look for more than a marginal additional boost to economic activity from this rate cut. Household debt levels are just too high to accommodate a renewed splurge in spending. Furthermore, as far as job creation is concerned, the biggest potential boost to the environment



for employment would be an improvement in the educational and skills profile of the country rather than any particular boost from monetary policy.

Source: *Econometrix*, 25 March 2010; *Creamer Media's Engineering News*, 25 March 2010

South Africa's Reserve Bank will shortly release results of a study into the gap between the central bank's main interest rate and prime lending costs, but is not formally investigating competition between commercial banks, according to Finance Minister Pravin Gordhan.

The banking sector in South Africa is dominated by four major banks, Standard Bank, Absa, Nedbank and FirstRand and has been criticised for being uncompetitive, allowing banks to charge consumers more than their overseas peers. Dominique Strauss-Kahn, managing director of the International Monetary Fund, said more competition should be introduced into the banking sector to help tackle inflation. "The South African Reserve Bank has indicated to the National Treasury that there is no investigation on interest rates charged by commercial banks," Gordhan said in response to a written question in parliament.

"Instead, there is a joint committee to discuss the spread between the repurchase rate and the prime lending rates ... and their report will be made public very shortly, within one or two months," he added.

The joint committee of members of the central bank and the Banking Association of South Africa (BASA) was formed in May last year after former central bank Governor Tito Mboweni questioned the steady 3.5 percentage point gap between the Reserve Bank's base rate and commercial bank's prime rates.

Currently the repo is at 6.5 percent and prime at 10,0%.

Mboweni had also complained that the interest rate charged to some customers, over and above prime, was too high.

Between August 2006 and June 2008 South Africa's Competition Commission looked at, among other things, the level of bank charges.

It found that charges to consumers for transactional accounts and payment services were, with some exceptions, "well above" the level that effective competition would allow.

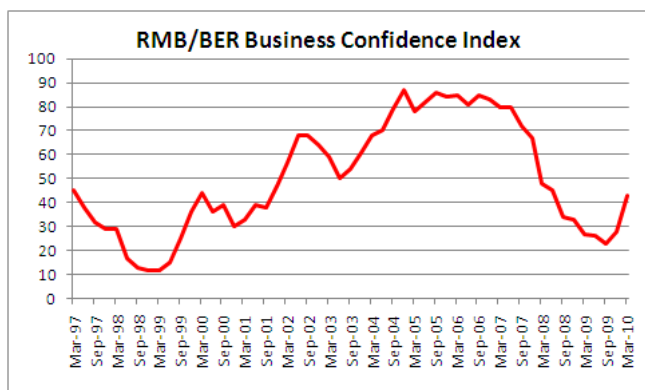
Competition Commission chief Shan Ramburuth, told a parliamentary committee that a joint structure, including treasury and the central bank, was looking at how best to implement recommendations emanating from the earlier enquiry.

"The fact is the enquiry has got people to rethink their behaviours and how they work. The extent to which that has happened is hard to tell,"

Source: *Engineering News*, Reuters, 10 March 2010

While the 15-point climb in the Rand Merchant Bank (RMB)/Bureau for Economic Research (BER) quarterly Business Confidence Index (BCI) for the first quarter of 2010 was "heartening", RMB chief economist Etienne le Roux warned that the improvement remained patchy and "heavily leveraged" towards the health of global demand.

The BCI rose from 28 points to 43 points in the first quarter of the year, recording its single biggest increase between two consecutive quarters in 16 years. It was now back to the level where it had been before the global economic crisis started.



However, while the index, along with other indicators, provided some evidence that the domestic economy had entered an “upward phase” in the business cycle, the researchers warned that some realism was still required. Confidence remained in the “net negative” territory, or below the 50-point level, which showed that the majority of respondents to the survey were still pessimistic in their outlook, said the researchers.

Further, the jump in the BCI was mainly as a result of a surge in the confidence of wholesalers, which RMB and the BER warned was traditionally a sector that delivered volatile results from one quarter to the next.

“Although there is no doubt that the economy is recovering, we are not yet in a broadly based upswing. While gross domestic product growth of more than 3% is possible this year and next, the longevity of the upswing hinges on higher levels of consumer and private investment spending ultimately taking over from what should be a strong rebound in exports and inventories in 2010, as production levels catch up with demand”.

Source: Rand Merchant Bank, Bureau of Economic Research, March 2010; Creamer Media's Engineering News, 9 March 2010

Key Indicators	2006	2007	2008	2009	FC2010	Ytd Feb-10
GDP	5.6	5.5	3.7	-1.8	2.4	n/a
GDFI	12.1	14.2	11.7	2.3	0.9	n/a
Residential	7.7	-0.3	-5.7	-9.3	2.7	n/a
Non-res	13.4	20.2	12.6	1.9	4.7	n/a
Construction	21.9	42.7	24.9	35.9	8.9	n/a
CPI	4.6	7.1	11.5	7.2	5.7	5.9
PPI	7.7	10.9	14.3	0.1	3.3	3.1
Interest rate	11.2	13.1	15.2	11.8	10.5	10.5
Exchange Rate (R/\$)	6.77	7.05	8.25	8.27	8.04	7.56
Exchange Rate (R/Euro)	8.52	9.66	12.05	11.49	11.53	10.57

Source: Econometrix, Stats SA, Reserve Bank

A fixed exchange rate regime would not be a solution for South Africa, according to National Treasury director general Letsetja Kganyago. He pointed out that it would be hard to implement and that it would carry a range of economic costs.

"Such a regime would require South Africa to give up its monetary sovereignty and adopt the same monetary policy stance to the country whose exchange rate is being targeted, even if it is not appropriate for domestic economic

conditions," he said at a Mail & Guardian trade and industrial policy event.

South Africa's current managed float approach towards the currency, seemed to be the "most-reliant and correct" approach, when judging global economic history and performance.

"With the recent global collapse of financial markets, South Africa's prudent fiscal policy, credible monetary policy and an exchange rate that was allowed to absorb capital flows shocks have helped [the country] to sustain economic growth and jobs."

The Congress of South Africa Trade Unions wants the government to fix the currency and do away with inflation targeting of between 3% and 6%, arguing that it will lead to higher economic growth and jobs.

Prior to 2000, the monetary and fiscal authorities used a forward book - future agreements to provide foreign currency at a specific rand value - to sustain the value of the exchange rate, despite continuous downward pressure, and in 1998 domestic interest rates rose as high as 25%.

Fixing the exchange rate not appropriate for SA.

Kganyago commented that the country's experience in trying to fix the interest rate and control currency came at "very high school fees".

The rand, which gained about 30% in 2009, has hardly moved in either direction from its elevated level this year, and South African manufacturers had said that the strong rand had been putting pressure on South African industries.

However, Kganyago said that the rand's recovery was accompanying the normalisation in global investor appetite in especially commodity-linked countries such as South Africa, Brazil and Australia.

Further, the appreciation of currency reduces the risk premium on local financial assets and, in turn, the cost of financing a country's economy. The stronger rand also helped to lower the rate of inflation, and reduced the cost of imported components of the government's infrastructure investment programme, therefore, easing pressure on public finances.

Source: Engineering News, Loni Prinsloo, 23 March 2010

Consumer spending increased for the first time in six quarters in the final three months of last year, as wages increased and job losses eased, improving the outlook for growth this year.

Household expenditure increased an annualised 1.4 percent after dropping a revised 1.9 percent in the third quarter. Spending had contracted every quarter since the three months to September 2008 and fell 3.1 percent last year, the first annual decline since 1992.

Consumers account for two-thirds of expenditure in the economy and a recovery in spending will help to boost gross domestic product (GDP), which expanded an annualised 3.2 percent in the fourth quarter.

Gross domestic expenditure, which includes spending by consumers, the government and companies, increased an annualised 5 percent in the three months to December, following a contraction of 1.6 percent in the third quarter.

Consumer spending on durable goods, such as cars and televisions, surged an annualised 15.2 percent, compared with 0.7 percent growth in the third quarter. However, sales of semi-durable goods, such as clothing and food, contracted.

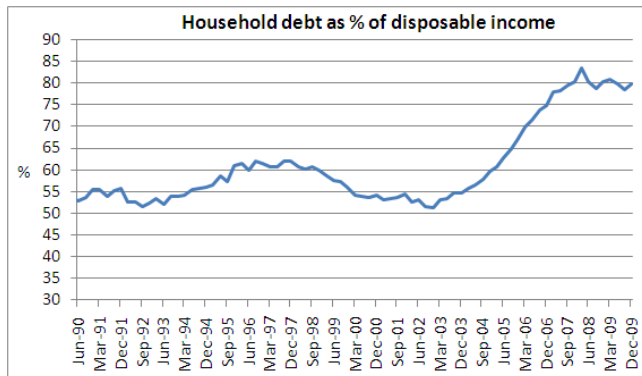
"The overall improvement in real final consumption expenditure by households was underpinned by a turnaround in real household disposable income in the fourth quarter.

Household debt still very high at 79.8% of disposable income.

Spending growth was moderated by rising consumer debt levels, which increased to 79.8 percent of disposable income in the fourth quarter from a revised 78.4 percent in the previous three months.

The recession has curbed investment by firms, with gross fixed capital formation dropping an annualised 0.9 percent in the fourth quarter, compared with a revised 6.5 percent contraction in the previous three months.

Investment spending at state-owned companies increased 8.7 percent in the fourth quarter, following a 17 percent expansion in the previous three months.



Source: Business Report, Nasreen Seria, 24 March 2010; Stats SA, Global Insight

If the Commission for Conciliation, Mediation and Arbitration (CCMA) does not receive additional funds from National Treasury, it will not be able to pay its bills at the end of March.

According to the Business Report, the CCMA's bank balance currently stands at about R2.4m, but due are payments of about R34.4m, including R11.9m for full-time staff salaries and R4.3m for part-time commissioners' salaries. Overall, the CCMA is R32m short.

CCMA director Nerina Kahn said that they have been lobbying since June last year for additional funds,

"We have been told that another R32m will be paid, but it has not been signed off," Kahn said.

According to the report, the CCMA's case load increased to

about 150 000 in the year to March 2010 from about 136 000 the year before, with more than 60% of these cases handled by part-time commissioners.

Source: Fin24.com, 23 March 2010

Building and construction trends

The civil construction industry in South Africa could shrink by almost a quarter this year, costing thousands of construction workers their jobs. This is evident from the latest survey of the civil engineering industry by the South African Federation of Civil Engineering Contractors (Safcec).

The slow pace of government expenditure on infrastructure is one of the reasons for the contraction, which could have disastrous consequences as thousands of companies reduce their workforces.

According to Henk Langenhoven, Safcec's construction economist who compiled the report, there is a close relationship between turnover and job provision over the long-term.

Safcec has dramatically adjusted its former expectation that the industry would contract by 10% in 2010. It became evident that in 2009 there had already been an 11% drop. This is despite government's renewed commitment to expenditure of R846bn on infrastructure over the next three years.

Safcec said the crippling repercussions of last year's election on government decision-making have not abated. The awarding of tenders has dramatically declined. Furthermore, institutional decline is a serious issue in South Africa, said Safcec. Levels of confidence in the industry are at a trough and are expected to recover only late this year, thanks to demand for civil engineering services from the mining industry, the South African National Roads Agency Limited (Sanral) and the Trans-Caledon Tunnel Authority (TCTA), the government agency that manages expenditure on water infrastructure.

Source: Fin24.Com, Antoinette Slabbert, 21 March 2010

Competition in the construction sector is intensifying. A few years ago, there would have been five bidders for a construction project, said Aveng CEO Roger Jardine, "now there are 20 bidders for the same job."

The current construction market was highly competitive, which was placing pressure on margins, noted Jardine. In fact, he added, managing margin was one of the big risks for the company as it navigated a post-recession environment.

The group's construction and engineering division in South Africa and Africa saw margin increase from 2,9% to 4,6% in

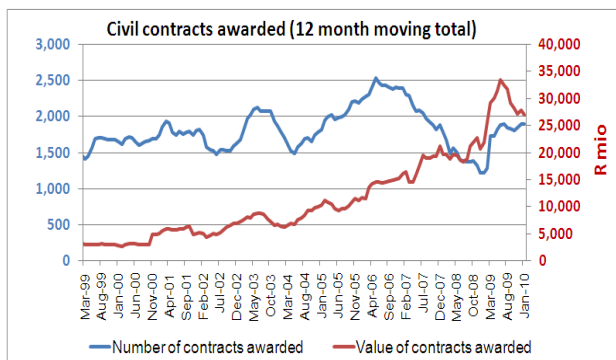
the last six months of last year compared with the same period in 2008, but construction and engineering margin in Australasia and the Pacific region dropped from 5,5% to 4,2%.

What bloodied the balance sheet was the drop in margin from 10,4% to 3,6% in the manufacturing and processing division. Jardine said a lacklustre steel sector was mainly to blame for this, as Trident and Steeledale saw volume drop a combined 13,4% from the last six months of 2008. However, he was positive that the steel market was showing modest signs of improvement as volumes for the reporting period were up 1,1% on the first six months of 2009. He said steel prices had also been improving since June 2009, but that the rate of recovery was expected to be slow.

Much of Aveng's steel fortunes were tied to that of the automotive and construction sectors, both of which suffered major declines in 2008. All in all, said Jardine, he expected the construction market to remain tough, adding that Aveng was focused on improving its performance "by unlocking efficiencies". "We are paying a lot of attention to our procurement strategy, for example. We are looking at how we can use our scale as a company to gain cost benefits from procuring tyres and fuel."

Jardine added that Aveng has shed 500 jobs over the reporting period. He said the market would dictate if this number would grow. The one factor he was particularly concerned about was the slow-down in the roll-out of public sector infrastructure projects. "They continued to be delayed, and that is of great concern to me."

Aveng's two-year order book stood at R32,7-billion at the end of December 2009, up from R30,4-billion in June 2009. Revenue for the six-month reporting period was down 5% at R16,8-billion, with operating profit dropping 29% to R686-million. Headline earnings a share declined by 33%.



Source: Creamer Media's Engineering News, Irma Venter, 17 March 2010; Stats SA; Industry Insight

Relaxed lending requirements are luring potential house-hunters back in droves to the residential property market, leading to a price leap. According to data collected by mortgage originator Ooba, the local residential sector has continued to show price growth in February, with a 7.8% increase in average house prices from January to February coming in at R895 031.

"The banks' more relaxed deposit criteria have stimulated buyer activity and supported increased application volumes," said Ooba CEO Saul Geffen.

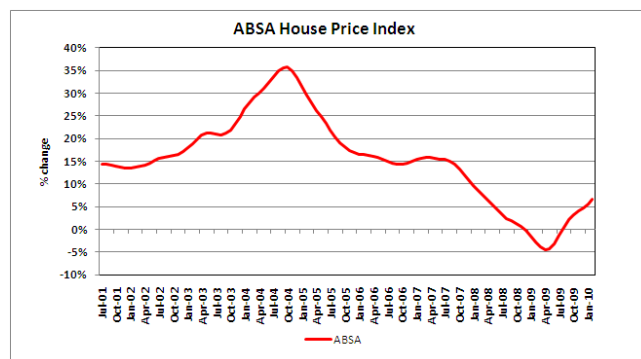
According to Ooba, the average approved bond size showed a year-on-year (y/y) increase of 13.9%, in line with higher purchase prices and lower deposits recorded in February.

"We've been easing deposit criteria since September last year," said Johan Botha, senior economist at Standard Bank. Home loan applications increased threefold between September and October as a result. Botha said the bank's decision to offer 105% home loans to first-time buyers had had a direct impact on house prices. "It also contributed to positive sentiment that the economy is recovering," he said. According to Ooba, the average deposit dropped by 8.9% in the last 12 months.

Absa's February house price index confirmed Ooba data. Average nominal value of houses improved y/y in all three categories of small, medium-sized and large houses during the month, said Jacques du Toit, Absa senior property analyst. The housing market is expected to gain further momentum during 2010, and he expects nominal values to be about 6% higher than in 2009.

Banks are relaxing lending requirements.

The average small house (80m² to 140m²) saw a 1.6% y/y increase in nominal value to R676 800, compared with a revised growth rate of 0.7% recorded in January, said Absa. Values of medium-sized houses (141m² to 220m²) went up 2.2% y/y to R953 600 in February, after a revised increase of 1% was registered in January. The average nominal value of large houses (221m² to 400m²) increased by 3.3% y/y in February to R1.4m, up from 3.1% in January.



Source: Fin.24, Leanie Wessels, 16 March 2010; Absa, Global Insight

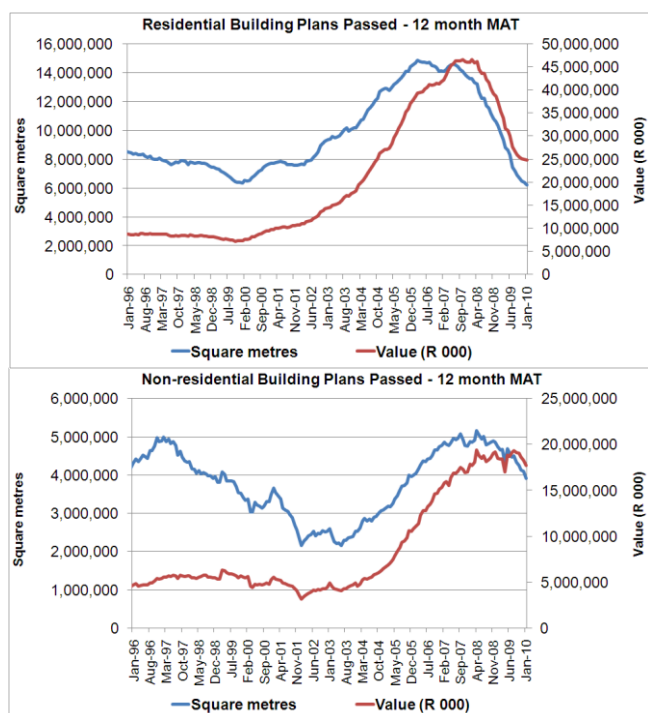
The recovery in building plans passed would likely only gain traction towards the end of this year, Investec economist Kgotso Radira said, as Statistics South Africa (Stats SA) revealed that the value of building plans passed by larger municipalities at current prices had declined by 17,4% year-on-year in January.

The decline was mainly as a result of a 53,6% decline recorded by the non-residential sector and an 8,6% drop recorded by the residential sector. Additions and alterations had, however, grown by 9,4% year-on-year in January. KwaZulu-Natal, Gauteng, North West province and the Free State had all recorded declines in the value of building plans

passed, with the remaining five provinces having recorded marginal increases.

Meanwhile, Stats SA said that the value of building plans passed by larger municipalities, at constant 2005 prices, had declined by 20,5% year-on-year in January. The biggest decline in the value of building plans passed, at 2005 prices, in January, was non-residential buildings, where a decline of 55,3% was recorded. This was followed by the residential buildings sector, which recorded a 12,1% decline. However, additions and alterations had increased by 5,3% year-on-year in January.

Radira noted that with building confidence seeming to be improving in the first quarter of this year, the value of building plans passed could improve, going forward. The recovery would be gradual, but would be supported by low interest rates, moderating inflation and improving real income growth, the economist stated.



Source: Creamer Media Reporter, 17 March 2010; Stats SA; Global Insight

Domestic and international cementitious industry sales trends and news

Mafikeng Cement Company (MCC) is reinitiating its limestone exploration project with a view to eventually building a \$150-million to \$170-million, one-million-ton-a-year cement plant with its joint venture (JV) partner, Kenya's Athi River Mining (ARM). An earlier JV agreement with a global cement producer and construction contractor fell

through in 2008. MCC CEO, Rajen Ghasi says ARM acquired a 70% stake in MCC in October 2009.

MCC signed an agreement with Orascom in 2007 and was on the verge of its second phase of drilling and exploration for limestone in the North West province when Orascom, acquired by Lafarge, pulled out of the project at the end of September. It was a significant setback for the company, as well as for the poor communities in an area which has an unemployment rate of more than 60%.

"We were told by an Orascom representative and the company's legal representatives, the BDH law firm, that we must now negotiate with Lafarge, which made an offer to the community's chiefs to mine in the area. However, the chiefs rejected the offer," Ghasi says.

The Department of Trade and Industry requested Orascom not to withdraw from the project, but without success. MCC's lawyers are currently trying to establish whether the company has a case against Orascom, which will then be taken to the Competition Commission.

The project involves a deposit of limestone, situated on 22 000 ha of land to the south and south-east of Mafikeng. By 2007, only 40% of the land had been explored, at a cost of about R7-million. The Council for Geosciences and the National Council for Cement and Building Materials (NCB) India helped with the basic exploration, geological mapping and prefeasibility reports. Ghasi says that the project was feasible from the start, with a suitable quantity of raw material for cement manufacturing.

He points out that one of the early challenges in this project was the land dispute among the tribal authorities. However, it was settled through discussions and assistance from different levels of government. The communities became aware of the positive economic and social impact of the project.

MCC's vision is to create sustainable jobs and grow a sustainable business. More than 500 jobs will be created to run the plant and it is anticipated that thousands of people will be employed when the plant and site are operating at full capacity.

Ghasi adds that the project will deliver a significant financial injection into the Mafeking area. Many small-scale ancillary businesses will also be established, supporting the plant and proper training will be provided for skills development of the local people. He says that the work on the project is in progress and the remaining prospecting will be completed soon. The JV has already started work and the drilling company will be on site soon. On February 17, this year, ARM Kenya MD, Pardeep Paurana visited South Africa and met with the Premier of the North West Province, the MEC for Economic Development and senior officials in Mafeking. The Premier and the MEC extended their support for the success of the project.

Ghasi points out that local and global demand for cement, as well as its value-added products, is growing significantly. Other projects in progress in the Mafikeng area include stone aggregates and clay projects.

Source: Creamer Media's Engineering News, Petronel Smit, 19 March 2010

New entrant in the South African cement market, Sephaku Cement, in which JSE-listed Sephaku Holdings owned a 80,2% interest, has appointed Nedbank Capital to be lead arranger of project finance facilities for new cement projects in the North West province and Mpumalanga. Sephaku Holdings is a minerals exploration, development and investment company, with a range of mining and exploration projects.

It is understood that the company will be the biggest new entrant in South Africa's cement market place since 1934, with total capital cost of the two projects at R3.3 billion, and project finance facilities likely to exceed R1.8 billion. Sephaku Cement's CEO, Pieter Fourie indicated that the arranging mandate paved the way for funding the construction of the Aganang project in the North West, and the cement milling plant in Mpumalanga, the Delmas project. One year ago the company entered into a full turnkey agreement for these projects with Sinoma International Engineering Company of Beijing, the largest supplier of cement plants worldwide, on a fixed price basis. Sinoma was responsible for Lafarge South Africa's recent Lichtenburg expansion project.

In August 2009 Sephaku completed the commissioning of the 1.2 million ton flyash beneficiation plant at Kendal power station. Last month Sephaku Holdings said it was in advanced negotiations with a global financial institution regarding an equity investment of \$40 million (about R300 million) by that institution into Sephaku Cement. Fourie commented, "our biggest strength is our intellectual capacity. We have an excellent contingent of cement professionals with significant experience in all areas of the industry". He said that construction of the Aganang and Delmas projects would start within the next few months, with a target completion by the third quarter of 2012.

Despite the global economic downturn having impacted on cement demand, Sephaku Cement expected cement demand to outstrip supply again from 2014 onwards.

*Source: Worldcement.com, 11 March 2010;
Aggregate research.com, Roy Cokayne, 9 March 2010;
Engineering News, Chanel Pringle, 8 March 2010*

South Africa's biggest cement producer, Pretoria Portland Cement, expects capital expenditure in 2010 to be between 850-950 million rand (\$114.8 million) and to slow in 2011 to 800-900 million rand. Pretoria Portland Cement (PPC) said in a presentation to investors that 2010/2011 replacement capex was under review due to lower activity in the country. The cement company, which supplies infrastructure projects such as Eskom's Medupi power station, said to date it has supplied 70,000 tons of cement to Medupi power station in Limpopo.

The group said its dividend cover would remain in the target range of 1.2-1.5 times normalised earnings. It added that current gross debt to earnings before interest, tax, depreciation and amortisation cover of 12 times was well within its conservative target of 2 to 3 times cover.

Source: Reuters, Gugulakhe Lourie, 16 March 2010

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