CESA

Consulting Engineers South Africa

PRESS RELEASE

IMPACT OF THE POST ECONOMIC CRISIS AND THE 2010 BUDGET SPEECH ON THE CONSULTING ENGINEERING INDUSTRY

An economic workshop was recently held in Johannesburg hosted by Consulting Engineers South Africa (CESA) at which 2 leading experts in their fields gave expert opinion on the Impact of the Post Economic Crisis and the 2010 Budget Speech on the Consulting Engineering Industry.

In his welcoming address Zulch Lotter, President of CESA stated that in spite of last year's financial dip public sector spending continued resulting in a better than expected year for the majority of Consulting Engineering firms. In terms of CESA's biannual Economic and Capacity Survey for the period July to December 2009 year on year income is down to 17% with Gross Fixed Capital Formation (GFCF) down to 1,2% from 5,2% in 2008. Indications are that 2010 will be a tight year. The industry Confidence Index that had remained at 98% since 2002/5 was down to 75% in the first quarter of 2010 with the South African Federation of Civil Engineering Contractors expecting a 25% downturn. In spite of this in his budget speech the Minister of Finance has committed to an infrastructure spend of R846billion over the next 3 years. As an industry we are waiting in anticipation to see what is going to happen. Graham Pirie, CEO of CESA stated that we are dealing with serious institutional weaknesses and that CESA is currently working via Business Unity South Africa (BUSA) to try and deal with the public sector weakness in terms of delivery.

Zulch Lotter welcomed the 2 guest speakers at the seminar: Nicola Weimar, Senior Economist at Nedbank Group Economic Unit; and Ian Marsberg, Macro Strategist of ABSA Capital's Economic Research Division.

Nicky Weimar – Senior Economist at Nedbank Group Economic Unit

Nedbank's View on Fixed Investment Outlook for South Africa

Nicky Weimar, Senior Economist at Nedbank started off by stating that the slowdown we experienced in 2009 was not surprising, 2008/2009 was the first sizeable downturn since 1990/91and was largely as a result of the loss of momentum in the private sector plus the cutbacks in government capital expenditure. The 2nd quarter saw weaker capital expenditure by government and the trend continued contracting in the last quarter. Eskom, Transnet and communications played a prominent role in 2009 to the benefit of the Construction Industry.

2010 and Beyond

We can expect to see a strong and sustainable economic recovery although companies are risk adverse and reluctant to invest in capital expenditure. There is the start of recovery in the private sector. Weimar noted that private sector still account for the bulk of investment activity, although public corporations were growing fast the gap between private and government investment was significant. Recent developments are encouraging and the economy is starting to emerge from the recession with a recovery in exports following on the turn in domestic expenditure in the last quarter of 2009. The bounce in exports is the result of the turn in the global economy. A stabilization stimulation has been created by Governments in industrialized countries. This is unique as it has to be noted that this is the largest synchronized government response to any recession on record. Weimar stated, "This has resulted in the death of the world's traditional consumer, they have not got the ability to spend as usual – the government has stepped into the breach in order to create artificial stimulation". In this regard South

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Africa was assisted by a strong growth in emerging markets: e.g. China who are building their way out of the crisis; a demand for commodities e.g. coal, iron and steel, which is a blessing for SA exports: the job market in SA has stabilized with signs of marginalized reemployment and no further job shedding. But, Weimar notes that the economic recovery needs to gain momentum in order to translate into higher fixed investment activity.

South Africa

Demand for commodities is good for mining and manufacturing. Growth is expected in consumer spending with a steadier labour market together with lower interest rates will make recovery possible. We can expect a turn in asset/property prices with banks willing to lend 100% mortgage bonds. The 2010 FIFA Soccer World Cup is expected to result in 300 000 visitors resulting in a 0,6% increase in GDP. As far as Government spending is concerned they are attempting to reduce the deficit and contain spending which will result in a cut in capital expenditure but social grants will be extended.

As far as infrastructure spend is concerned the Government has big plans but there is a lack of detail. A number of new projects were introduced as early as 2007 including Eskom, Transnet, Roads and the World Cup but since then there have been no new projects coupled with a sharp drop in government expenditure. Fixed capital investment activity is expected to drop further contracting in 2010 and slower in 2011 onwards

Ian Marsberg – Macro Strategist, ABSA Capital

Ian Marsberg, Macro Strategist at ABSA Capital started off by stating that he has a somewhat more positive view on the economic recovery than Nicky, but nevertheless believes that the recovery is likely to be relatively gradual. Marsberg expects the economy to grow 3.3% in 2010, with growth rising to more than 4% in 2011.

International Outlook

Marsberg believes that the global recession is over and that the recovery is gaining traction. Furthermore, he believes that fears of the world sinking into another recession as the governments of the world start withdrawing the significant stimulus injected during the downturn may be overdone. Although some may be concerned over a jobless recovery in the US, the economy has recently started to add jobs and consumer spending is returning. There are also signs that investment in certain sectors are recovering. He believes that as governments slowly start to withdraw the stimulus administered during the recession, consumers will slowly take over to support the recovery. As far as the Eurozone is concerned, he believes that help is already underway for Greece, but that structural rigidities in the Eurozone are likely to see growth in the region being somewhat weaker than in the US.

Investors are in search of a return on their investment at the moment. Given the low interest rates in developed markets, emerging markets with relatively high interest rates appear to be attracting strong capital inflows. South Africa may not be number one on the list of foreign investor interest, but the country has also been benefiting from these flows.

Although the recession in South Africa felt painful with almost 1million jobs being lost, it was not as bad as in other parts of the world. The decline from its peak to the trough of the recession, GDP fell by a relatively modest 3%. Marsberg does not think that there is much chance of a double dip recession in South Africa and that the recovery is most likely to show a V-shaped recovery.

Households and credit

Household debt levels in South Africa remain at high levels, but the interest rate cuts that we saw since December 2008 are helping consumers by having reduced their debt servicing costs. As far as house prices are concerned, Marsberg believes that cycle has turned as house prices are rising and the average house price has already surpassed previous highs. Aspirational consumption is rising, as spending on durables, such as cars and furniture, as well as semi-durable goods are gathering momentum. Equity markets are well off their pre-crisis lows and consumer confidence rose markedly in the first quarter of 2010 and is back to levels of about 2 years ago. Although it is showing some signs of stabilization and improvement, relatively weak labour market conditions still pose challenges for a strong return in household consumption expenditure this year.

As far as credit is concerned, there are signs that a turning point may have been reached following 5 consecutive months of contraction. The drag on overall credit extension is coming from the corporate sector as companies are still not investing given the significant amount of slack that was built up during the recession, and it is expected to take a while before corporate credit demand recovers. On the household side, mortgage advances are already slowly going higher. Marsberg believes that it may take until the 2nd quarter of 2010 before we see stronger signs of growth in total credit extension.

FIFA 2010 World Cup

An impact study conducted by Grant Thornton, a consultancy firm, shows that about R17.4bn has been spent on the construction and upgrading of World Cup stadia, while an estimated 480,000 visitors are expected to attend the event. The total impact of foreign visitor spend on GDP is estimated to be in the region of ZAR11.5bn or about 0.5% of GDP. While the event is undoubtedly good for South Africa, from an economic perspective Marsberg believes that the perceived benefits may sometimes be overstated. Sectors such as travel and tourism are likely to benefit, but these positives could be offset by a loss in productivity in other sectors of the economy.

Marsberg believes that concerns over a post-World Cup investment slump may be overdone. Fixed investment by public sector entities such as Eskom and Transnet will likely make a significant contribution to investment in the coming years. Investment by Eskom in particular will be crucial to avert the economy from grinding to a halt owing to a lack of a reliable electricity supply. Skills shortage is nevertheless a concern in the construction of these multi-billion-rand projects.

Inflation

The significant fall in inflation since 2008 has been surprising which, along with weak growth conditions, has allowed the South African Reserve Bank to cut interest rates by 550bp since December 2008. However, Marsberg does not believe that inflation will permanently fall to sustainably low levels. Services inflation, in particular, remains a cause concern. Potential electricity price increases of about 20% at a municipal level, together with significant tariff hikes in other services such as refuse removal and water provision, is also of concern. While inflation expectations have fallen, nominal unit labour costs continues to increase by more than the 6% upper limit of the South African Reserve Bank's inflation target range. All these factors add to the input cost structure of the South African economy, so despite the moderation in inflation since 2008, the medium-term inflation outlook remains uncertain.

The Rand

Despite the relative strength of the rand, manufactured exports rose towards the end of last year as an improved global environment offset the currency strength. Marsberg believes that the rand will remain relatively strong throughout 2010 as the currency finds support from strong global commodity prices, an improved global risk environment, a positive economic growth outlook and a smaller current account deficit financing requirement. While a relatively strong rand may pose challenges to some exporters, it is likely to benefit the import of capital equipment used in large infrastructure investment projects.

Overall, Marsberg believes that the world is now a better place as compared to 2009, but it is not as rosy as in 2006-07 when the economy grew at more than 5% per annum. Nevertheless, economic growth is expected to continue gaining traction and by 2011 he expects the economy to grow by more than 4%.

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May 2010