Copy of South Africa, Nigeria and Algeria market analyses prepared for the ITTO project, PD700

SOUTH AFRICA

Trade Update

Market unusually quiet for what is the busy time

Although this is supposed to be the busy time of the year millers and traders are saying that the market is much less robust than it was this time last year. Obviously the electricity power shortages continue to have an impact.

Additionally the tourist sector has been badly affected by the new visa regulations which have resulted in the delay of several resort/hotel refurbishment projects.

The market is still suffering from credit restrictions and this is exacerbated by many municipalities delaying payment for contracts concluded due to budget problems.

Price discounts giving some timbers an edge in the market

Meranti has been affected by some distributors discounting aggressively to destock as sales are slowing. This is both because some sizes are not available and because of the exchange rate.

Eucalyptus from S America is filling some of the gaps where meranti sizes are unavailable. Some end users are even trying spruce from Europe as an alternative. Traders dealing in meranti are trying to stick to their price but all this is doing is opening the door for their competitors with other species.

Sales of W. African timbers are slow and importers complain of the long lead times asked by suppliers. The very long shipping times are also a disadvantage. Iroko and okoume sales have slowed as have sales of African mahogany. One of the major door manufacturers in South Africa suffered a prolonged worker strike which has also caused stocks to fall.

Imports of US hardwoods continue steady despite the disadvantageous exchange rate. Prices for some US hardwoods have been adjusted downward due to slower Chinese sales and this has helped US hardwoods to maintain market share.

The decking market in South Africa remains very subdued. There have been some price declines for garapa and massaranduba due to the Brazilian exchange rate changes so these species have taken some market share from balau as shippers are trying to maintain their FOB price.

The pine market has suffered from the consequences of a number of strikes and breakdowns at the mills such that sales are lower than last year. Pine millers have reduced stocks to such an extent that delivery times are stretching more than usual and because of this there is little or no discounting of prices.

Plywood stocks have risen recently mainly because the government is delaying the awarding of infrastructure projects. The supply of plywood will increase considerably when the largest local producer completes its expansion programme.

Traders need to price in exchange rate fluctuations

One of the major problems facing the timber industry is the exchange rate. The rate has moved from around R11.50 to the US dollar at the beginning of the year to R14.14 and this has played havoc with the pricing of imports.

Unfortunately there are quite a few South African traders who are not pricing on a replacement basis so there is a wide gap on available prices. This will last until stocks are depleted and new stocks come in at the new rates.

The South African Rand is traditionally one of the most volatile emerging country currencies as it is the most liquid and used a lot for hedging emerging exposure worldwide.

This has not helped the confidence of the timber buyers as they are unable to forward price contracts with confidence. Additionally, producers in other countries with weak currencies are not passing the exchange gain onto their customers, as in the case of meranti.

On the other hand, W African producers who sell in Euros have managed to keep the prices more stable and are picking up market share because of this.

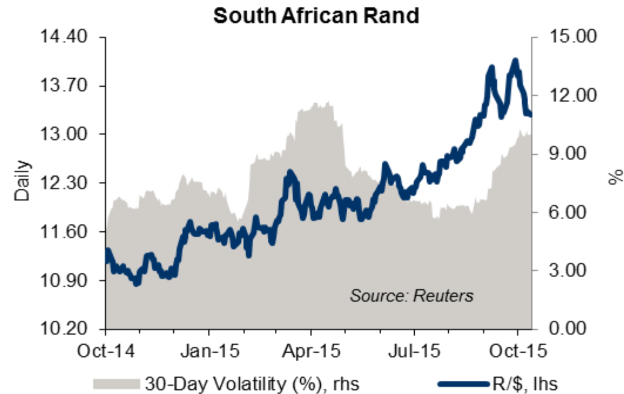
Economic Overview

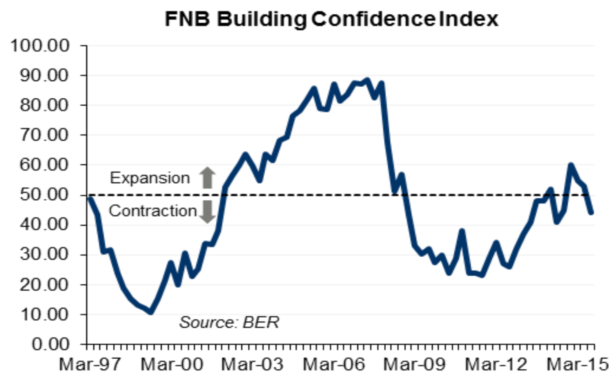
The South African economy has run into a barrage of headwinds over the past 24 months or so including widespread labour action, falling international commodity prices, a weakening currency and, most recently, frequent electricity outages. As a result, real GDP growth slowed to 1.5% in 2014, its worst performance since the economy contracted by 1.5% during 2009 in the wake of the global financial crisis and an associated drop in external demand.

The situation has not improved this year as troubled national electricity utility Eskom struggles to keep the lights on after decades of neglected maintenance and investment spending. In addition to the domestic issues, the exchange rate has been hit by the emerging market currency rout in 2015, sending the rand down almost 20% to fresh record lows in the year to date. The rand and other emerging market currencies have taken a battering in the wake of growing concerns about the health of the Chinese economy, which has been the growth engine for emerging markets in recent history.

The growing stream of concerning economic news out of China and doubts about how well foreign portfolio inflows to South Africa will hold up once US monetary policy normalisation starts, will likely see more losses in the rest of the year. However, we expect some strengthening in 2016 as the bad news reaches saturation point and as South African interest rates rise further.

As for consumer prices, after rising to 6.1% in 2014, consumer price index (CPI) inflation eased substantially during the first half of 2015 due to lower international oil prices. CPI inflation slowed to a four-year low of 3.9% y-o-y in February, but a weaker rand, higher international fuel prices and a hike in fuel levies and taxes following the 2015/16 National Budget speech as well as higher electricity prices resulted in CPI inflation rising toward 5% y-o-y in the following months. Looking forward, we expect CPI inflation to average 4.7% this year before jumping to an average of 6.3% next year due to base effects.





According to the latest data from Statistics South Africa (StatsSA), the value of building plans passed for residential buildings rose 10.8% y-o-y during the January to July period this year. However, the pace of activity slowed by a seasonally adjusted 4.9% q-o-q during May to July. This slowdown in activity was also evident in the FNB/BER building confidence index, which dropped nine points to 44 in the third quarter as weaker profitability hurt confidence among manufacturers and retailers of hardware.

However, this stood in slight contrast with actual building activity by main contractors which improved during the period in question. Q3 marked the third straight quarter of weakening building confidence to the effect that the headline index is now down 16 points y-o-y and below the 50-point neutral threshold. FNB's John Loos noted that: *"Office vacancy rates remain high and the demand for retail space is dwindling as consumer spending comes under increased pressure."* Unfortunately, the outlook for the construction sector is not rosy and we expect growth in the building sector to remain subdued in the near term.

NIGERIA

Construction overview

The construction industry represents one of Nigeria's main economic growth drivers. However, lower crude oil prices and the associated impact thereof on the fiscus will necessitate lower fiscal capital expenditure. This, in addition to persistent power supply constraints, will add pressure on the construction industry in 2015. Indeed, construction industry real value-added growth slowed to just 6.4% y-o-y in Q2, down from 11.2% y-o-y in Q1. The construction industry will likely continue to face headwinds for the duration of 2015 as crude oil prices are projected to remain low while the central bank's staunch support for naira stability will continue to deter investment.

Recent Highlights

Purchasing Managers Index (PMI) – The non-manufacturing PMI edged higher to 50.7 in August, up from a reading of 50 the month before. Unfortunately, construction was not among the industries that recorded values in excess of 50 in August – PMI values above 50 are usually indicative of increased activity.

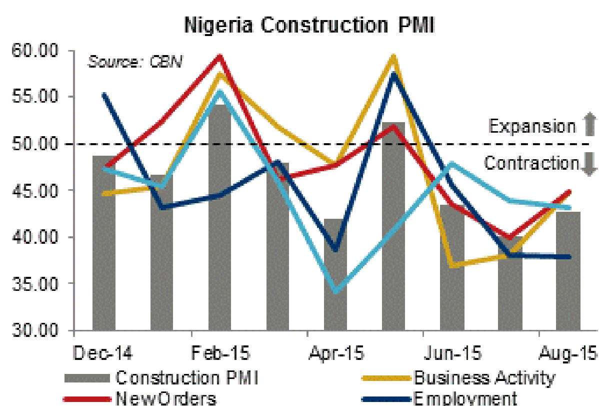
That said, the construction PMI increased from a reading of 40 in July to 42.7 in August, which suggests that the industry is at least contracting at a slower pace. Turning to the construction-related sub-indices, business activity increased by 6.8 points to 44.8 in August, while new orders increased to the same level, 4.8 points higher than the reading recorded in July. The employment and inventory sub-indices remained fairly flat, with the former still hovering around its weakest level this year.

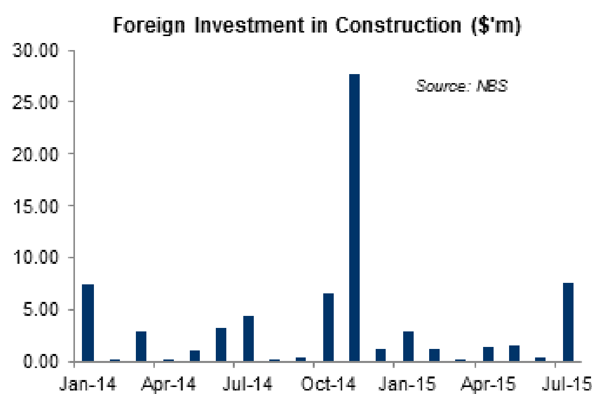
The fact that the construction PMI remains well below the 50 mark does not bode well for the industry's growth prospects during Q3 and we would not be surprised if construction industry growth slows even further.

Trade in Wood – According to the Nigeria National Bureau of Statistics (NBS), wood exports increased to N2.9bn in Q2, up from N2.5bn in Q1. Meanwhile, wood imports dropped sharply from N4.4bn in Q1 to N3bn in Q2 – the lowest level of wood imports recorded since 2013 Q1. The drop in wood imports could potentially signal a decline in domestic demand, but factors such as a weaker local currency and tight foreign exchange liquidity could also have played a role in this regard.

Foreign Investment – The NBS estimates that foreign investment directed to the construction industry increased to $7.6m in July, up from $0.4m in June. However, foreign investment in the construction industry was still 23% y-o-y lower over the first seven months of 2015.

The 'order-based' foreign exchange system characterised by tight forex liquidity will continue to sour investor sentiment while it remains in place. Investors will likely remain on the sidelines due to the fear of a large devaluation which will erode the value of assets denominated in naira terms. We believe tight forex liquidity conditions will persist for the duration of 2015 and as a result, we do not foresee a significant rise in foreign investment during H2.





ALGERIA

Economic Background

Algeria is one of the most hydrocarbon-dependent economies in the world. In fact, oil & gas account for 98% of total exports and more than 60% of fiscal revenues. The government – supported by these large oil inflows – plays a dominant role in the economy. The construction and public works sector has been one of the main beneficiaries of these oil revenues, largely in the form of the government's massive public investment programme.

At the same time, the private sector is small and its development is stunted by corruption, red tape, and restrictive government policies. As a result, economic activity is dependent on government finances. Therefore, before turning to the recent performance of the industrial sector, it is important to give an overview of government finances.

Official data shows that hydrocarbon revenues declined by 21.2% y-o-y in 2015 H1. Although this was partially offset by an increase in non-hydrocarbon revenues, total revenues still declined by 7% y-o-y. Despite this, the government raised spending by 7.9% y-o-y. Specifically, current spending increased by 7.9% y-o-y and capital

spending by 9.6% y-o-y, which resulted in the budget deficit widening by some 70% y-o-y to DZD1.16trn ($12.1bn, or approximately 13.8% of GDP in H1).

At the same time, export earnings slumped by 41.7% y-o-y, which caused the current account deficit to widen sharply to $13.2bn in 2015 H1. Although foreign exchange reserves are still very high at nearly $160bn, it is being eroded at an astonishing rate, falling by $20bn during H1, and by $34.4bn since mid-2014.

Since July, the government has taken firmer action to prevent the deficit from spiralling out of control, adopting a supplementary budget, with the dual aim of reining in the budget deficit and, perhaps more pertinently, to reduce imports. As part of this, the government *reduced* the tax rate on manufacturing companies from 23% to 19%; it kept the tax rate on construction and tourism companies unchanged at 23%; and, it increased the rate on other activities (especially companies that import goods that are resold in the same form) from 23% to 26%.

These changes are aimed at supporting domestic industrial production in order to bring down the country's large import bill. At the same time, the increase in the tax on importing firms is aimed at suppressing imports. For the same reasons, the government also reduced the tax on professional activities (or TAP) for goods-producing companies from 2% to 1% and from 2% to 1.5% for construction companies, while keeping the rate at 2% for other companies.

On the spending side, little was changed in the supplementary budget. It sets spending at DZD8.75trn, 1.3% lower than in the original budget. The budget for recurrent expenditure was left unchanged at DZD4.97trn, while the investment budget was lowered from DZD3.89trn to DZD3.77trn. Notably, it cut the budget for 'support for access to housing' by 12.4% to DZD257.1bn. In our view, though, capital spending will be substantially lower than stated in the budget, especially since the government decided to freeze all projects that have not yet started, unless it gets "*the express authorisation of the prime minister*".

Furthermore, with oil prices expected to remain low over the medium term, and oil & gas export volumes expected to continue its long-term downward trend over the next few years, we believe that government finances will remain under pressure. Therefore, in order to prevent foreign exchange reserves from falling too rapidly, it is expected that capital spending will fall to a much lower level over the next few years. In turn, this will weigh heavily on the construction sector**.**

Apart from the change in the tax regime, the government has also tried to reduce imports by tightening restrictions on import licences and by making it more difficult for importers to get letters of credit from banks. Furthermore, *Maghreb Emergent* reports that new rules dictate that construction companies must use domestically-manufactured construction materials for projects that are funded by the State. The central bank has also allowed the dinar to depreciate significantly in recent months, which will make it more expensive to import.

Industrial Production Slows in 2015 Q2

The construction and public works industry has grown rapidly in recent years on the back of the public investment programme. In turn, this has boosted the demand for industrial materials, such as cement and steel. The government also provides support for these industries in order to boost domestic production and bring down construction material imports.

Various cement factories and steel mills are therefore either under construction or in the planning phase. The resulting increase in domestic construction material production, combined with the above-mentioned tightening in import restrictions, has led to construction material imports falling from $2.4bn over the first eight months of 2014 to $1.7bn over the same period this year.

Despite the ongoing development of the construction material industries, recent public sector Industrial Production Index (IPI) figures suggest that growth has slowed, although this could also reflect a shift from public to private sector production. The overall public sector non-hydrocarbons IPI increased by 2% y-o-y in 2015 Q2, down from an average growth rate of 3.2% p.a. over the previous five quarters (2014 Q1 - 2015 Q1). Notably, though, most of the sub-indices of the IPI contracted on a y-o-y basis in Q2 – only the agri-food processing and textile industries expanded.

The sub-index for construction materials, ceramics & glass contracted by 4% y-o-y, down from an average expansion of 2.7% p.a. over the previous five quarters. This contraction was driven by a significant y-o-y decline in the production of red construction materials (bricks), cement, and glass. Meanwhile, the sub-index for the steel, metal, mechanical & electronic industries contracted by 5.9% y-o-y, which was the sixth contraction out of the past seven quarters. Finally, the IPI data shows that the **wood and carpentry industry** has been struggling of late, contracting by 20.7% y-o-y in 2015 Q2 and by 10.9% p.a. on average from 2014 Q1 - 2015 Q2.

Construction & Wood-Related Components of IPI (Public Sector, % change y-o-y)

Sub-index	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	Average: 2014 Q1 - 2015 Q1
Non-hydrocarbons IPI	**0.1**	**2.8**	**5.1**	**0.8**	**7.3**	**2.0**	**3.2**
ISMMEE (Steel, metal, mechanical & electronic industries)	**-8.0**	**-11.6**	**-11.1**	**-14.1**	**2.8**	**-5.9**	**-8.4**
Steel	0.3	-39.6	-36.8	-19.2	-14.5	17.5	-22.0
Construction materials, ceramics & glass industry	**-5.5**	**0.2**	**-5.9**	**10.5**	**14.1**	**-4.0**	**2.7**
Glass industry	-24.6	-9.2	-9.4	-7.1	-5.6	-7.9	-11.2
Red construction materials (bricks)	-9.8	-9.6	0.7	1.7	-3.0	-20.2	-4.0
Hydraulic binders (cement)	-3.8	2.5	-6.0	11.6	17.9	-3.2	4.4
Other construction materials	-4.6	-11.4	-7.8	20.0	3.5	15.6	-0.1
Wood, paper & cork industry	**-8.7**	**9.0**	**-22.8**	**-7.3**	**-14.6**	**-20.7**	**-8.9**
Carpentry - production of intermediate wood products	-5.4	10.0	7.6	-19.4	-26.7	23.6	-6.8
Furniture industry	-10.8	0.6	-49.4	-28.4	-25.7	-47.7	-22.7

Source: Office National des Statistiques