BLEAK TIMES AHEAD

Steel and engineering sector in the doldrums

By Nelendhre Moodley

The state of the metals and engineering sector for the next five years remains bleak, with the possibility of an upswing only towards the end of the period. Thus the embattled sector is set to face more challenges.

This is according to the Steel and Engineering Industries Federation of Southern Africa's (Seifsa's) economist Henk Langenhoven.

He says that the average economic/ commodities cycle lasts roughly between 20 and 30 years, and, to date, we have experienced an eight-year upswing from 1999 to 2007 and a subsequent downswing for another eight years from 2008 to 2015.

"However, recovery from the current downturn is expected to be slower, with a number of industries tracking sideways growth for roughly the next five years. Price decreases between 2007 and 2015 have been 40% since their peak," Langenhoven explains.

Sideways growth will mean that companies are going to be focused on improving efficiencies and decreasing costs, with little or no hope of significant growth.

"In line with the 5-year oil-price term contracts, which are pegged at around $55 per barrel, the expectations are for subdued growth for the next few years," he reiterates.

Economists continue to amend growth forecasts downward in line with the sluggish industry performance. The International Monetary Fund recently trimmed its 2016 forecast for South Africa to 1.5%, due to poor electricity supply and high unemployment.

Finance Minister Nhlanhla Nene's medium-term budget speech in October last year also outlined a miserable growth forecast for the year ahead. Economic growth expectation of 2.4% for 2016 was amended to 1.7%. "Electricity supply constraints, falling commodity prices and lower confidence levels have resulted in our growth forecasts being revised lower," Nene said.

More job losses in the short term lie ahead as companies look to reduce costs, improve efficiencies and increase production. Delegates at the Jo'burg Indaba, held in October last year, also heard that companies in business rescue mode would soon go into liquidation. A bleak forecast, indeed.

Seifsa economist Henk Langenhoven

A number of industries will track sideways growth for the next 5 years.

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IS THERE LIGHT AT THE END OF THE TUNNEL?

Minister Nene also stated that, without economic growth, there is no revenue growth, and, without revenue growth, expenditure cannot increase and the nation cannot develop and succeed.

As such, the question to ask, says Langenhoven, is if growth and demand recovery is forecast in the next five to ten years, what can be done now to ensure that we are ready when the opportunity arrives?

He goes on to advise that stimulus to the economy is an imperative, as well as increasing exports and decreasing imports. He also advocates injecting investment into the economy that will result in long-term benefits and rolling-out infrastructure projects, particularly for power, which has, thus far, stymied growth, "so that when the opportunity knocks, we are not caught unprepared".

At the Consulting Engineers South Africa (CESA) inaugural infrastructure indaba, held at Emperors Palace, in early November, CESA president Abe Thela pointed to a recent KPMG study, which stated that, by 2018, there would be an infrastructure development gap amounting to R6.5tr.

The keynote speaker from the

Department of Transport, director-general Godfrey Selepe, added weight to the argument by explaining that infrastructure investment was an imperative and that a backlog of R197bn in road infrastructure was currently the case.

Langenhoven notes that government incentives have helped buffer some sectors in distress, including the automobile industry. The incentives, such as tax rebates and subsidies, do much to invigorate and promote certain industries, he states.

Furthermore, policy measures such as the anti-dumping measures, go a long way to protecting the steel industry. The 10% steel import tariff is helping curb imports and stimulate the local economy.

He goes on to explain that 50% of how the local industry unfolds is as a direct result of global economic impacts. "We are competing largely with the global industry – in fact, about 50% of products are exported. The industry contraction of 1.3% in the third quarter of 2015 is a clear indication of the challenged state of the sector, which has subsequently impacted company performance."

He noted that renegotiation of steel maker ArcelorMittal's (AMSA's) off-take agreement with Kumba Iron Ore has thrown it a massive lifeline, and re-investment by AMSA's parent company in the local plant will enable the steelmaker to invigorate the company. Moreover, 'the 10% import tariff and the rand-dollar exchange rate' would hopefully see recovery of the steelmaker.

> "The average economic/commodities cycle lasts roughly between 20 and 30 years, and, to date, we have experienced an eight-year upswing from 1999 to 2007 and a subsequent downswing for another eight years from 2008 to 2015."

But not all companies are as fortunate as AMSA. A number of steel and engineering sector companies are bearing the brunt of the global economic crisis, including Russian company Evraz Highveld Steel and Vanadium, which is in business rescue mode.

The catch 22 situation, however, is the building of a 5mtpa steel plant in South Africa in 2017 by the Industrial Development Corporation of South African (IDC) and China's Hebei Iron & Steel Group.

The facility, which is earmarked for location either near Witbank in Mpumalanga or Richards Bay in KwaZulu-Natal, has seen steel sector participants go hot under the collar as they question the need for another multi-billion-dollar steel plant, when such an investment could potentially wipe out the existing steel industry.

The new steel plant would inject some $10bn into the economy, but at what cost to the local steel industry, asks Langenhoven.

In an earlier interview, the IDC head of mining, Mbuyazwe Magagula, said that the steel plant was aimed at the projected growth in Africa – one of the globe's growth hot-spots.

The financier also believes that the steel market, which is currently in surplus, will be in deficit in the next five to ten years, owing to growth driven by infrastructure development across the African continent.

Magagula explained that several studies indicated that steel demand on the continent would increase significantly in the next decade to justify new steel capacity, and this was an investment with an eye to future growth. ■

SA has a 10% steel import tarrif.
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SA's infrastructure gap will amount to R6.5tr by 2018.
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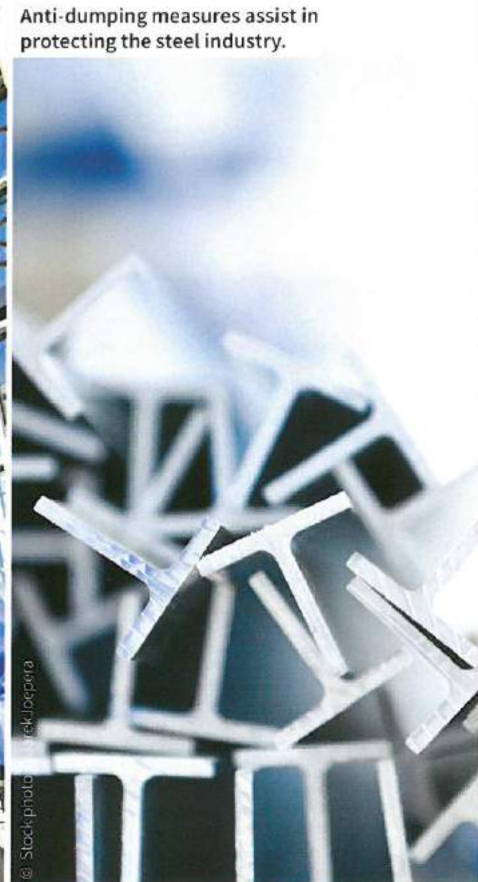
Anti-dumping measures assist in protecting the steel industry.
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