CONSTRUCTION TAKES A GREAT LEAP FORWARD

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After a series of ups and downs through 2004, the construction industry is reaping the fruits of the expansion of housing credit, government programs to encourage affordable housing, the Growth Acceleration Program (PAC), more supportive regulation, and the boom in the economy. It has become a primary engine of industry growth and job expansion.

Construction in 2010 is projected to be almost double (13.3%) the expected growth in gross domestic product (7.2%) compared with 2009, according to LCA Consultores. After braking for the global crisis, construction, which represents about 5% of Brazil's GDP, is again picking up the trend of 2008. Despite the pullback in 2009, this means that for the last six years annual growth in construction jobs has averaged double digits.

"The prospects are good for all segments of the construction sector.... In December total construction jobs will be 16.6% higher than in December 2009, and higher than expected for the



economy overall (6.9%)," predicts Fabio Romão, an LCA Consultores' economist. The percentages also reflect job growth in industries that supply construction, such as paint, ceramics, and cement.

Investment boom

Investment in construction has grown solidly since 2005, reaching R$259 billion in 2008, 43% of the total invested in the country that year, according to the Getulio Vargas Foundation (FGV). Although the global crisis then reduced investment, Paulo Safady Simão, president of the Brazilian Chamber of the Construction Industry (CBIC), predicts that investment in construction, like jobs, will return to the previous pace, adding that "These numbers represent outstanding performance, and bigger investments are expected in the next few years. The Growth Acceleration Program (PAC) the development of the deep sea oil field, the 2014 World Cup, the 2016 Olympics will all boost the sector."

The Survey of Construction of the National Confederation of Industry (CNI) indicates that construction companies will purchase more inputs and raw materials over the next six months. Preserving the reduction in the industrial products tax (IPI), which was adopted in 2009 and is scheduled to end late this year, would help sustain this expansion, says Danilo Garcia, a CNI analyst.

In the 12 months ended in August 2010, domestic sales of basic and finished products rose 17%, reports the Brazilian Association of Manufacturers of Construction Materials (Abramat). As for cement, "We are moving completely in the opposite direction to the rest of the world," says José Otavio Carvalho, vice president of the National Syndicate of the Cement Industry (SNIC). This year, cement sales will grow about 14%, as they did in 2008 and 2009.

Government programs are seen as essential to this performance because they create incentives to meet the demand of lower-income Brazilians for housing (see state

GDP and Capital Formation (% change)

	GDP	Gross Fixed Capital Formation		
		Total	Construction	Machinery and Other
1996	2.2	1.5	3.2	0.2
1997	3.4	8.7	8.5	8.9
1998	0.0	-0.3	1.1	-1.8
1999	0.3	-8.2	-2.9	-13.9
2000	4.3	5.0	2.0	8.5
2001	1.3	0.4	-2.1	2.9
2002	2.7	-5.2	-2.2	-7.9
2003	1.1	-4.6	-3.3	-5.8
2004	5.7	9.1	6.6	11.1
2005	3.2	3.6	1.8	5.1
2006	4.0	9.8	4.7	13.5
2007	6.1	13.9	4.9	19.9
2008	5.1	13.4	8.2	16.5
2009	-0.2	-9.9	-6.3	-12.1
2010	7.2	21.0	13.3	26.4

Sources: Institute of Geography and Statistics, and LCA Consultores' projections.

and municipality initiatives, page 15). Before the federal initiatives, there was no private sector supply of housing for classes C and D due to low profitability, bad debts, and lack of bank financing. "Low-interest financing for low-income people and tax incentives for the sector have made it feasible to supply low-cost homes," Garcia comments. He points out that this process is also producing upward social mobility, which implies higher family consumption.

Financing sources

In 2004, 321,149 houses were financed, 53,787 of them from savings and the rest by the Guarantee Fund for Workers (FGTS). In 2009, 897,000 houses were financed, 302,680 of them from savings accounts — a fivefold increase — and the rest by FGTS and the federal program Minha Casa, Minha Vida (My House, My Life).

In 2004, house financing totaled R$7 billion, R$4 billion of it by the FGTS and the rest by the Brazilian Savings and Loan Institutions (SBPE). Just five years later, it had reached a staggering R$49 billion. "The market leap occurred in a short period and was not only quantitative but also qualitative. In 2004, financing was scarce and limited to the middle class. Even the FGTS funds were limited to families with incomes of up to five times the minimum wage (US$450). The My House, My Life program finances homes for families with incomes up to three times the minimum wage who had previous been practically excluded from the housing market," explains Ana Maria Castelo, project coordinator for the construction sector in the Brazilian Institute of Economics (IBRE) FGV.

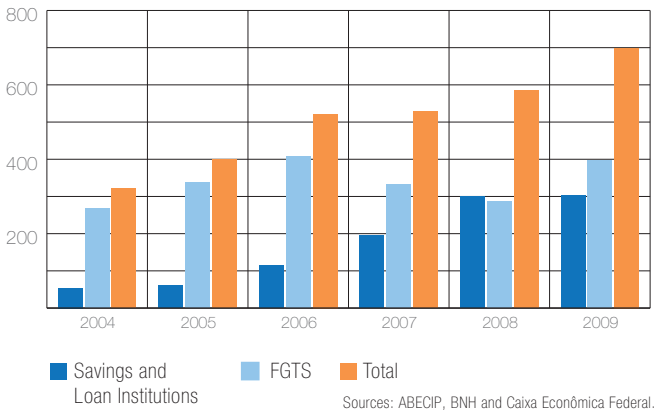
Sector overhaul

Until 2004, construction had struggled because of the scarcity of financing resources, public and private, for investments and housing loans. Changes to the real estate market law then have brought more security to

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NUMBER OF HOUSES FINANCED

(thousand units)



Sources: ABECIP, BNH and Caixa Econômica Federal.



investors and expanded resources for housing. "The decision to use the construction sector as a development tool was essential. Besides contributing approximately 40% to fixed investments in Brazil, the sector is critical to ensure sustainable growth and help to resolve bottlenecks in national infrastructure — social, urban, logistics, energy," Simão says.

In addition to the new law that allows mortgages and liens as collateral, the Central Bank's decision to require banks to direct more resources from savings to housing financing was fundamental, Castelo adds: "No changes in the regulatory framework would make families seek financing. Economic stability, greater security, and above all income growth have increased both supply and demand."

Eduardo Zaidan, director of economics for the Construction Industry Union of the State of São Paulo (Sinduscon-SP), believes that the real estate market has grown since 2006 largely because financing has expanded. "In 2002 and 2003 the housing finance system did not fund more than 1,000 buildings a year," he says.

As the credit market has developed, financing terms have become more favorable: loan maturity has increased from 12 to 30 years and for financing from savings and loan institutions annual interest rates have fallen from about 12% a year above the Central Bank benchmark rate to about 8% to 9%. The cost is even lower for My House, My Life borrowers. This has encouraged a group of large construction companies to go public since 2005, which has increased the inflow of resources. "Banks are more confident because they realize the advantage of having captive customers for 20 to 30 years. With lower interest rates, customers felt safer in seeking credit," Castelo explains.

However, the construction sector became so overheated that in the first half of 2008 costs soared and there were fears of shortages of material and skilled labor. Then, with the international crisis, credit disappeared and construction was paralyzed. But not for long: the government moved swiftly to offer working capital for business and in early 2009 launched Minha Casa, Minha Vida.

Labor

In 2009, the Annual Social Information Report (RAIS) of the Institute of Geography and Statistics (IBGE) reports that the number of formal workers (with signed contracts) increased by 6.9% for all

Photo: Flavio Demarchi/Getty Images



Employment

	Total		Construction		Industry		Commerce		Services		Agriculture	
	(Thousands)	(% change)	(Thousands)	(% change)	(Thousands)	(% change)	(Thousands)	(% change)	(Thousands)	(% change)	(Thousands)	(% change)
2000	20,437		1,086		5,236		4,240		8,809		1,065	
2001	20,862	2.1	1,111	2.3	5,310	1.4	4,470	5.4	8,898	1.0	1,074	0.8
2002	21,953	5.2	1,096	-1.4	5,593	5.3	4,817	7.8	9,320	4.8	1,127	5.0
2003	22,596	2.9	1,040	-5.1	5,748	2.8	5,106	6.0	9,502	1.9	1,200	6.4
2004	24,270	7.4	1,109	6.7	6,340	10.3	5,569	9.1	9,954	4.8	1,297	8.1
2005	25,655	5.7	1,235	11.3	6,566	3.6	5,984	7.5	10,567	6.2	1,303	0.4
2006	27,133	5.8	1,380	11.7	7,055	7.4	6,303	5.3	11,048	4.6	1,347	3.4
2007	29,033	7.0	1,603	16.1	7,561	7.2	6,810	8.1	11,685	5.8	1,374	1.9
2008	30,871	6.3	1,897	18.4	7,811	3.3	7,287	7.0	12,466	6.7	1,410	2.6
2009	32,150	4.1	2,112	11.4	7,872	0.8	7,650	5.0	13,097	5.1	1,419	0.6
2010*	34,361	6.9	2,459	16.4	8,423	7.0	8,104	5.9	13,934	6.4	1,442	1.6

Sources: RAIS, and LCA Consultores' projections.

sectors but by 11.4% in construction. Employment in construction grew 14% on average for 2005–2009. For 2010 LCA Consultores predict a 16.4% increase in construction jobs, compared to 6.9% for all sectors. In 2010, it is expected that of 2.2 million new formal jobs created, 300,000 will be in construction.

The Monthly Employment Survey (PME) of the Brazilian Institute of Geography and Statistics (IBGE) shows that workers' incomes have been rising above inflation: income growth in July, compared to a year earlier, was 5.1% for all categories but 14.2% for construction.

The government thinks raising the minimum wage has been important in expanding employment in Brazil. Carlos Lupi, Minister of Labor and Employment, explains: "With the increase of the minimum wage by 64% in real terms in the Lula administration, the purchasing power of the people, and thus their consumption, has increased, creating a strong domestic market."

In 2009, the number of formal workers increased by 6.9% for all sectors but by 11.4% in construction.



All these factors together generate demand for labor and construction materials. "Today one of the major issues in the sector," Castelo says, "is the training and qualification of manpower. This has led construction companies to partner with SESI (Industry Social Service) and SENAI (National Service of Industrial Education)."

The National Index of Construction Costs-Market (INCC-M) increased by 6.2% from January to August this year compared with 9.1% in the same period of 2008.

Inflation

In 2008, the construction industry was moving full speed ahead, prices for wages and materials accelerated, and there were shortages of inputs. The world economy was booming and high oil prices pushed up industrial costs. Then in 2009 the scenario changed, and prices fell because of recession and tax relief from countercyclical government policies.

Since January prices have begun to show a small increase, but not nearly as substantial as in 2008. The National Index of Construction Cost-Market (INCC-M) saw materials, equipment, services, and labor increase by 6.2% from January to August this year compared with 9.1% in the same period of 2008. Wages have risen by 8%. "The high wages in 2008 reflected the overheated labor market," says Castelo. Romão projects that the INCC index will rise by 7.4% in 2010 compared to 3.3% in 2009, materials and services will be 6% more expensive, and labor 9% costlier.

Future

One concern for construction companies today, says Castelo, is productivity, which requires investments in technology so companies can produce more at lower cost. Other issues she raises are the sustainability of the recent expansion in house financing and the need to improve workforce skills.

REAL ESTATE INDEX

With economic stability and declining interest rates, investing in real estate becomes an attractive alternative for investors, especially pension funds. However, structural changes require indicators for tracking changes in the value of real estate. "In the current context it is highly desirable to have an index for commercial real estate," says Paulo Picchetti, coordinator of the Weekly Consumer Price Index of the Brazilian Institute of Economics of Getulio Vargas Foundation (IBRE-FGV).

The market wants information on what is happening with prices of commercial properties in different regions and types of enterprises. This year, therefore, the IBRE-FGV is launching the Brazilian Real Estate Value Index, which is designed to measure the profitability of commercial properties. "Encouraging investors to be more active in the housing market requires data that show with certainty price variations in major markets," he says.

Picchetti explains that a real estate value index will show clearly whether recent price increases should be characterized as a bubble. "Everyone has a strong feeling that prices have risen sharply but lacks comprehensive figures for a more consistent analysis. Historical series will give a picture of how property prices have evolved over the business cycle and whether properties are overpriced."

The sector is worried, too, about the exhaustion of resources earmarked for house financing, such as the FGTS and the 65% of savings deposits that banks are required to direct to financing houses. Castelo points out that the pace of contracting for new buildings is already outpacing savings deposit growth.

In these circumstances, there has been debate about creating new funding for housing loans by directing pension funds, which are now concentrated in commercial real estate, to invest in housing. The expectation is that the Ministry of Finance and the Central Bank will soon introduce measures to stimulate funding for housing.

Although a 1977 law introduced the Certificate of Real Estate Receivables (CRI), high interest rates pushed the instrument into the background. Since 2008, there have been some initiatives to securitize housing loans and offer an income tax exemption for individuals who invest in mortgage securities.

Resolution of these obstacles will promote sustainable growth in construction, especially a new leap in housing credit. With only current sources of funding it will be impossible in the next few years to double the volume of credit, as has happened since 2007. Castelo says, "At best, there would be some stability. Moving beyond the level already achieved would require the entry of new investors."



BETTING ON THE GAMES

The fact of Brazil will soon host two major international events — the World Cup (2014) and the Olympics (2016) — has generated positive expectations for construction. This is the sector that could benefit most from such mega-events, says Carlos Lupi, Minister of Labor and Employment.

Heavy investment in infrastructure, such as expansion and improvement of airports and construction and renovation of stadiums, is a priority for the public sector. "The financing of these works affects not only the entire construction sector, but also the mining, chemical, plastic, and glass industries," says José Silvestre Prado de Oliveira, coordinator of union relations at the Department of Statistics and Socioeconomic Studies (Dieese). João Alberto Viol, president of the Association of Architecture and Engineering (Sinaenco), points out that the country will have to correct deficiencies in urban environments, especially Rio de Janeiro city.

Based on planned investments of R$29 billion (US$17 billion), the Ministry of Sports projects that 120,833 direct and indirect new jobs will be added each year until 2016 and 130,970 more jobs a year between 2017 and 2027. "The construction of stadiums and the Olympic Village is an exceptional new development that helps heat up the sector," Viol says. It is estimated that construction alone accounts for about 60% of investments in stadiums.

Viol believes that up to the 2014 World Cup construction of stadiums will require R$3.6 billion (R$1.2 billion a year). He expects that "Spending will spike between the second half of 2011 and 2012. Construction to improve urban transportation will move later but should also peak in 2012."

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