Market View
Sub-Saharan Africa H1 2019

A POSITIVE OUTLOOK FOR CONSTRUCTION DEMAND IS LIKELY TO FUEL INFLATIONARY PRESSURE

Overall, outlook for construction activity in sub-Saharan Africa (SSA) is reasonably strong, but regional prospects vary widely. Ambitious social infrastructure programmes are forecast to underpin growth, with the housing and energy sectors expected to attract significant funding.

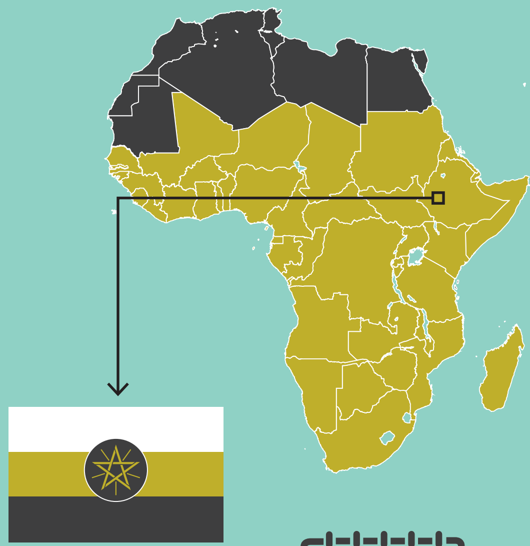
Each nation faces a unique and complex range of political and economic challenges, which may have the potential to destabilise this positive outlook. High levels of public sector debt across the region presents a considerable risk, especially in nations with high levels of foreign denominated debt.

"The cautiously optimistic outlook for construction demand across SSA comes at a time when the costs of construction materials are rising and contractor capacity is already stretched. Together, these factors suggest that upwards pressure on construction costs in SSA will continue over the medium term, which will create a challenging procurement environment."

Simon Herd
Managing Director MaceYMR

Overall GDP growth forecast for 2019 in Sub-Saharan Africa is...

2019
3.4%



Ethiopia has the strongest 2019 growth forecast at...

2019
8.8%

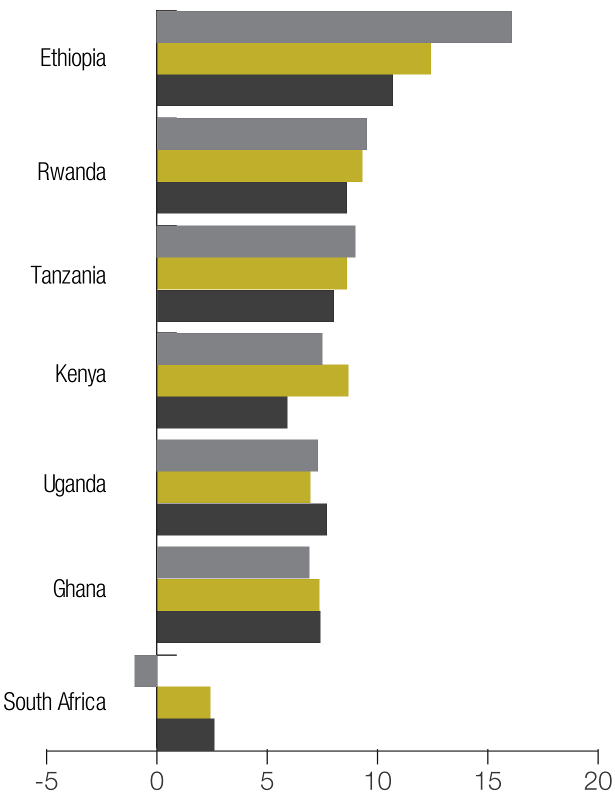
By the end of 2020 construction output in Ethiopia is forecast to grow at the strongest rate in SSA by...

END 2020
23%

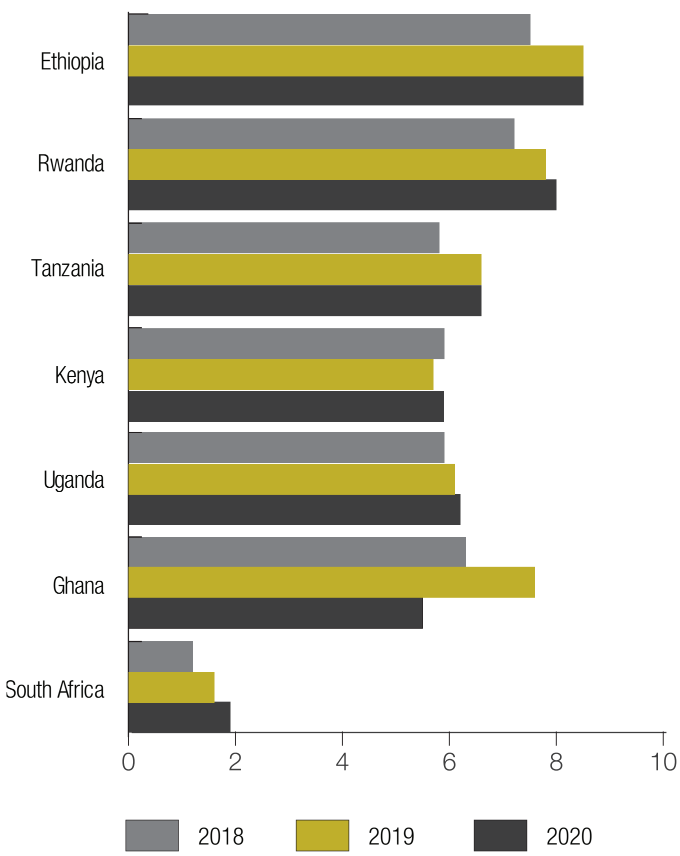
Over the next two years the Sub-Saharan Africa construction sector is forecast to grow at an average rate (per annum) of over...

2019-2021
6%

Construction output growth (real growth, % change)



GDP growth (real growth, % change)



REGION OVERVIEW

Against a relatively healthy economic backdrop, construction activity is forecast to grow across sub-Saharan Africa (SSA), at an average rate of over 6% per annum over the next two years, according to BMI, although significant downside risks exist.

Ethiopia, one of the region's largest markets, is leading the charge. Here, construction activity is forecast to achieve double-digit growth through to 2020. Construction activity in Kenya, Rwanda, Tanzania and Uganda is also forecast to expand over the medium-term and, amid a return to economic growth, prospects for construction in South Africa may improve. The anticipated hiatus in public sector activity due to the upcoming South African general election, however, suggests demand is unlikely to strengthen until later in the year.

This relatively bullish overall outlook relies on timely delivery of large infrastructure projects in the pipeline, but the ability and inclination to increase sovereign debt may impact on delivery. Over the past 12 months, high levels of sovereign indebtedness have weighed on credit ratings and planned public sector investment in countries with high exposure to debt denominated in foreign currency could be especially vulnerable if domestic currency were to weaken.

2018 was a turbulent year for global commodities markets. Production disruption, together with an escalation in trade tension between major economies contributed to an acceleration in construction materials price inflation across the region. Currency fluctuation also played a role – especially in South Africa where the rand depreciated against the US dollar by over 10% during 2018. A slowdown in the pace of global growth and rising stock level will help to ease pressure on prices but, at over 5%, the overall rate of inflation is still expected to be relatively high.

SOUTH AFRICA

Better economic prospects will hopefully drive a construction recovery in the second half of 2019 – following the election-induced hiatus in public sector investment – but headwinds remain. Input cost inflation is strong and several tier one contractors are facing financial difficulties. As demand strengthens, these factors will present challenges for project procurement.

ECONOMY

South Africa emerged from economic recession in Q3 of 2018, while GDP grew by 1.2% across the year. Retail, manufacturing and agriculture led the recovery, but construction continued to contract, and business and consumer confidence remains fragile. High unemployment, changes to tax policy and weak growth in credit availability weigh on consumer confidence, but February's IHS Markit South Africa PMI suggested business activity has stabilised.

Uncertainty regarding the adoption of the land expropriation without compensation policy continues to weigh on investors' confidence as the country counts down to the national elections in May. Assuming there are no major upsets, Oxford Economics predicts a brighter outlook for the South African economy. Their latest forecast suggests GDP will increase by 1.6% in 2019 and the rate of growth will accelerate to 1.9% in 2020 and 2.3% in 2021 as fixed investment strengthens and the pace of growth in household consumption accelerates.

There are downside risks to this improving picture, however, not least from the precarious financial position of several state-owned enterprises. Electricity sector reform is underway, but financial distress extends beyond public utility company, Eskom, and the 2019 South African Budget increased contingency reserves to support state-owner companies by US$400m. A more positive outlook also hinges on a political shift in a more business-friendly direction, and recent signs have been encouraging. Rigid labour market regulations and policy uncertainty, however, could constrain the outlook.

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CONSTRUCTION

Construction activity contracted by 1% in 2018. Non-residential construction activity suffered a sharp fall during the year, but this was partially offset by growth in residential activity.

Lacklustre demand and cashflow issues were compounded by fines levied on firms convicted of past collusion, making 2018 a challenging year for South Africa's largest contractors. Many have sought to reduce overheads and rationalise operations, but cash flow difficulties have proved too challenging for some, forcing several contracting firms to seek rescue packages.

Construction materials prices rose by 7% in November 2018, despite the subdued state of demand. The relatively high level of overall inflation concealed wide variation across material groups. Structural steelwork and reinforcement experienced particularly high inflation due to demand from the infrastructure sector.

Capital investment, announced in the 2019 South African Budget, was marginally lower than indicated in the 2018 Budget, by around 2%. Nearly US$38bn will be invested in building new schools and improving existing facilities over the next three years and higher education will benefit from a 20% upswing in infrastructure grant funding. This includes additional funds to complete student housing programmes at three universities: Nelson Mandela; Sefako Makgatho Health Science; and Vaal.

Ramaphosa's stimulus package, unveiled in September, includes US$30bn to start a new infrastructure investment fund and should boost construction activity over the medium-term. Initial funding will be used to leverage additional resources from a range of lenders, including the New Development Bank, and an Infrastructure Execution Team will be established to oversee implementation.

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Risks associated with delivering construction projects in South Africa have intensified. Recently, armed assailants have disrupted, or even halted, over 75 construction projects, with a combined value of US$1.8bn across the country. The severity of the situation has prompted the South African Forum of Civil Engineering Contractors to write to the government to demand urgent intervention. Without this, the Forum warns that investment and industry capacity could be seriously affected.

Near-term indicators of private sector construction demand are subdued and the upcoming general election will divert public sector attention away from progressing planned developments. Beyond this, the stimulus package and a brighter economic outlook suggest construction demand will strengthen after the election. BMI expects the construction sector to bounce back reasonably strongly, growing at a rate of 2.4% during 2019, with the pace of growth accelerating to 2.6% in 2020. That said, significant downside risks threaten this positive outlook and this projection may prove too optimistic.

KENYA

With pressure on input costs strengthening, and demand anticipated to remain stronger, it is likely that the uplift in prices will feed through into contractors' pricing decisions over the medium term. However, the precarious state of public finances and growing concern among foreign investors about corruption pose a downside risk to demand.

ECONOMY

Expanding by an estimated 5.9%, the Kenyan economy delivered another reasonably solid performance in 2018. The services sector grew steadily and favourable weather conditions provided a boost to agriculture activity in the second quarter.

Net foreign direct investment rose by over 40% during the year to its highest level since 2013.

Broader economic indicators are also positive. Consumer price inflation remains within the target range and consumer confidence had returned to positive territory. The December purchasing managers' index (PMI) reflected buoyant business conditions. At 54, the headline PMI strengthened relative to November and new orders rose sharply.

Robust economic growth is forecast over the next three years, with the annual pace of GDP expansion forecast to average 5.8%.

Impressive as this pace of growth is, restrictive government policy on lending may inadvertently be constraining overall potential. The regulatory cap on commercial lending rates, introduced in 2016, caps them at 4% above the central bank's benchmark rate. This widely criticised policy restricts banks' freedom to price risk, ultimately restricting credit availability. Hopes that the cap may be scrapped have been dashed by the National Assembly's Finance Committee after it withdrew its decision to amend the Finance Bill.

CONSTRUCTION

Kenya's construction sector grew by an estimated 10% in 2018, as work to upgrade the country's railways, roads and ports progressed and commercial development activity in Nairobi strengthened marginally.

Robust industry-level growth was achieved against a backdrop of public sector cutbacks in 2018. With gross government debt approaching 60% of total GDP, the government came under pressure to rein in spending and capital investment bore the brunt.

Hass Property tracked an 8% increase in Nairobi house prices in the year to Q3 2018. Growth in the price of houses outstripped apartment price inflation by a wide margin and rental growth was more muted at 4.7% over the period. Government plans to deliver 500,000 affordable homes across the country over the next four years will be financed by a new tax, payable by employees and employers. Detail about the location of new homes is still lacking and Hass reports this uncertainty is weighing on private investors' investment decisions.

Investment in renewable energy provision has been scaled up in an attempt to meet the government's target to attain 100% transition to green energy by 2020. 70% of the nation's electricity generating capacity comes from renewable energy sources. The first of three planned power station developments as part of the Menengai geothermal project recently reached financial close. The plants have a collective construction value of US$210m.

Factory-gate inflation slowed to less than 0.5%, on an annual basis, in Q3 2018. Reductions in the price of manufacturing food and electricity generation supressed the headline rate but inflation in the manufacture of fabricated metal products and mining and quarrying was significantly stronger – close to 10% – suggesting materials price inflation in the construction sector will come under greater upwards pressure during 2019.

The recent adoption of an 8% VAT on fuel will exacerbate pressure on construction costs.

Overall, due to the number of sizeable projects currently being built or in the pipeline, BMI forecasts strong growth for the Kenyan construction sector. Assuming these projects progress broadly in line with expectations, growth of nearly 9% is forecast in 2019, before the pace moderates to around 6% per annum from 2020. The scale and timing of public sector investment will be critical. Investment associated with President Kenyatta's Big Four agenda has been slow to materialise and reducing the high level of national debt may continue to take priority over the medium term.

ETHIOPIA

There's a bright outlook for industry activity, driven by infrastructure mega projects and a decisive political move to encourage foreign direct investment. Low foreign exchange reserves may impact on construction procurement and delivery.

Since Abiy Ahmed was elected by his party to replace Mr Hailemariam as Prime Minister in April last year, Ethiopia has seen significant political and economic reform. These reforms, combined with an improvement in relations with neighbouring Eritrea should help stabilise the region. IMF forecasts point to a strengthening economic outlook, with GDP predicted to grow at a rate of circa 9% per annum over the next three years.

Double-digit growth in construction activity is forecast in 2019 and 2020 and, by the end of 2020, is forecast to be 23% higher than in 2018. Investment in critical infrastructure will continue to be a prominent driver. Contracts were recently awarded on the US$77m Aluto Langano geothermal project, a welcome development several years after the project was announced.

Low foreign exchange reserves, due to weak export performance and high demand for foreign currency, have hindered investment by making overseas sourcing difficult. Forex payments require a permit and all transactions must be conducted through authorized dealers. Abiy has taken measures to increase the attractiveness of central bank bonds and reduce bureaucracy which may help to alleviate this problem over the medium term.

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In October, the World Bank approved US$1.2bn of funding to support government policies designed to accelerate economic growth as Ethiopia strives to become a lower-middle-income country. Funding will help to unlock private investment through public-private partnerships, and projects will focus on improving efficiency in telecommunications, power and trade logistics sectors.

Times of rapid political and economic change can be volatile. Support for Abiy's capitalist policies, and his approach to politics, is far from universal. His popularity will be tested next year when the nation heads to the polls.

RWANDA

With a relatively small but rapidly growing construction sector, investment in transport and logistics infrastructure will help to sustain a healthy pace of expansion over the next few years. Scarcity of construction materials may present problems for development, and this could fuel strong construction cost inflation.

GDP climbed by 8% in the first nine months of 2018 and Rwanda is forecast to maintain this growth rate over the next three years. Public investments have been the main driver of growth in recent years, but the private sector is poised to play a greater role going forward.

Relative to other East Africa construction markets, Rwanda is small, but activity is forecast to grow strongly over the next few years.

Rising by 12%, construction activity was a leading force behind economic expansion in the first nine months of 2018, as work progressed on large infrastructure schemes, including phase one of the US$400m Bugesera International Airport. Investment to increase energy generation via the National Strategy for Transformation also played a role. Relative to other East Africa construction markets, Rwanda is small, but activity is forecast to grow strongly over the next few years. BMI forecasts that growth will exceed 8% per annum over the next three years as work commences on four cargo and passenger ports at Lake Kivu.

Scarcity of construction materials is a challenge for development in Rwanda and is driving construction costs up. Annual inflation of more than 20% in the price of electricity generation, transmission and distribution weighed on construction costs and the price of fabricated metal products rose by more the 10%.

TANZANIA

Chinese investment is fueling bullish growth in industry activity and the volume of projects in the pipeline suggests this trend is likely to continue. The unpredictable political environment will weigh on industry growth and policies will continue to inhibit foreign direct investment in the region.

GDP grew by an estimated 5.8% in 2018, according to official statistics, and the pace of expansion is forecast to strengthen to 6.6% this year. Other indicators of activity paint a less positive picture. Recent tax revenues have fallen short of expectations and credit growth has stagnated.

In its recent review, the IMF identified several risks to this outlook. Notably, it raised concern about the nation's ability to attract the level of private sector investment required to deliver the government's development plan and highlighted the acute need for tax reform.

Doing business in Tanzania is relatively more difficult than in some of its neighbours, according to the World Bank's Ease of Doing Business ranking. This is largely due to the time and costs associated with importing and exporting materials. In 144th place, Tanzania ranked behind Rwanda (29th place), Kenya (61st place) and Uganda (127th place).

Growth in construction activity slowed to 9% in 2018 and the slowdown is set to continue, according to the latest forecast from BMI. In 2021, output is forecast to increase by 7.7%. Ongoing Chinese investment in large infrastructure schemes is a primary driver. Most recently, the Dar Rapid Transit agency awarded the China Civil Engineering Construction Corporation a US$160m contract to build the second phase of a rapid transit bus project in Dar es Salaam.

Growth in construction activity slowed to 9% in 2018 and the slowdown is set to continue

UGANDA

Dominated by large infrastructure projects, construction activity is growing strongly. Upwards pressure on construction materials prices is expected to continue and this will weigh on the cost of delivering construction projects in Uganda.

GDP grew by 5.9% in 2018. This was largely a result of a recovery in agriculture and strong domestic demand. Indeed, investor surveys indicate that business conditions and sentiment are buoyant. Construction output rose by an estimated 7.3% in 2018 due to buoyant activity on several large schemes in the oil, transport and power infrastructure sectors.

Enabling work for the new international airport at Hoima is underway. The new airport forms part of the supporting infrastructure required to unlock the potential afforded by the nation's oil reserves in western Uganda and around Lake Albert. However, for landlocked Uganda, development of the East African Crude Oil Pipeline, linking the oil fields to the sea, will be the crucial enabler. The final investment decision has yet to be taken and recent oil price volatility only adds to the complexity.

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In the highways sector, a successful bidder to build and operate the US$1.5bn road project linking Kampala with Jinja is due to be announced by the end of 2019. The road forms part of a broader transport artery linking landlocked nations with the Kenyan coastline.

Financing public investment programmes is a challenge, and the Bank of Uganda has expressed concern that the slowdown in global growth may trigger volatility in the domestic foreign exchange market, which could increase costs associated with servicing the country's foreign denominated debt. However, estimated at 28% of GDP, Uganda's exposure to external debt is low relative to some African nations.

Construction activity is forecast to increase by 6.9% in 2019, with growth accelerating to 7.7% in 2020. If infrastructure and oil sector investments proceed as planned, and private sector credit remains supportive, the longer term outlook for construction activity may become brighter.

GHANA

Robust growth in construction activity has driven bullish building cost inflation over the past 12 months and the strength of the outlook suggests no respite on the horizon.

Ghana's economy grew by an estimated 6.3% in 2018, driven by services sector growth. An unexpected 1% cut in the central bank rate in January 2019 will encourage inwards investment and boost domestic demand, strengthening the near-term outlook for growth. Furthermore, it has been suggested that a lower rate of inflation may be targeted in future. GDP is forecast to grow by 7.6% in 2019 and by a further 5.5% in 2020.

Problems with banking system liquidity came to the fore in late 2018 and the Ghanaian government authorised US$1.2bn to support the recapitalisation of six domestic banks to help them meet new minimum capital requirements. Decisive action helped maintain confidence and the IMF recently gave the financial system a clean bill of health, stating it was adequately capitalised and well-positioned to support credit growth and investment going forward.

Private sector activity continued to expand in February 2019. The headline PMI stood at 51.3, marginally down on January's level, but firmly in the increasing zone for the fifth consecutive month. The weakness of the Ghanaian cedi against the US dollar pushed purchase prices higher, but wage inflation moderated. Sentiment about demand over the next 12 months remains positive.

In August 2018, Ghana entered into a controversial bauxite-for-loans financing agreement with Chinese state-backed firm Sinohydro. This US$2bn agreement is a new form of infrastructure financing for the country, through which loans for infrastructure developments will be repaid through the export of refined bauxite. The first tranche of funding is set to fund 68 roads projects through to the end of 2020.

New housing delivery is high on the political agenda.

With an estimated housing deficit of close to 1.7 million homes, new housing delivery is high on the political agenda. The 2019 Ghanaian Budget announced additional support for the Mortgage and Housing Finance Market Scheme, following the 2018 pilot. The government has committed to a US$180m fund to leverage private sector capital to provide affordable housing. This is in addition to a variety of demand-led initiatives including rent-to-own schemes.

Construction activity in Ghana increased by an estimated 6.9% in 2018. The outlook for the construction sector is stronger, with the pace of growth forecast to exceed 7% over the next three years as the government continues to prioritise infrastructure development and encourages greater participation from overseas investors.

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