Market View

MENA H2 2019

MACE FORECASTS CONTINUED GROWTH FOR MENA GDP DESPITE A SLOWDOWN IN 2019

The MENA construction sector is forecast to expand at a rate of over 4% per annum, over the next two years, against a reasonably solid economic backdrop. Growth is expected to be driven by increasing infrastructure and housing investment and a greater role for private sector finance in social infrastructure delivery.

In recent weeks, downside risks to this relatively sanguine outlook have intensified significantly. Coronavirus and, following their recent sharp depreciation, the potential for oil prices to remain low for a prolonged period, have become prominent threats to the pace of economic growth across MENA.

If the actual impact of these threats proves to be limited – and the virus is contained relatively swiftly – MENA's healthy project pipeline should support construction activity growth across the region. Egypt's pipeline is especially buoyant, the UAE is poised to return to growth after a period of contraction and Qatar will continue to benefit from investment associated with the 2022 FIFA World Cup.

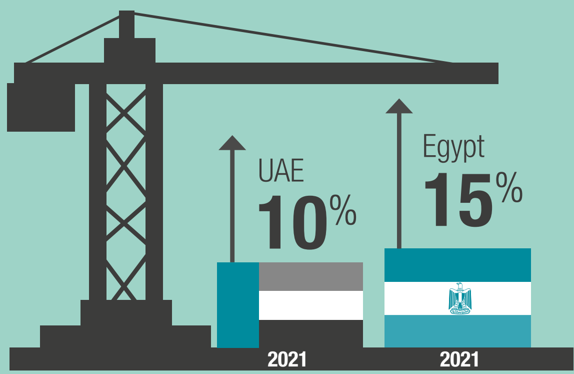
If, however, the impact is more sustained and substantial, MENA's construction sector stands to be adversely affected. Near-term, projects underway may be affected by supply chain disruption and workforce restrictions. Longer term, weaker economic expansion and lower oil-related revenue will weigh on public and private investment decisions and project appraisal viability may come under pressure.

"Faced with such uncertainty, procurement strategy should maximise flexibility to enable constructors and project teams to mobilise the most appropriate response to the challenges faced. In the event the impact of coronavirus is limited to a short, sharp, shock, the outlook is relatively buoyant and the best project outcomes will be delivered through early contractor engagement, maximising scope for competition and a pragmatic approach to risk. If the impact is more severe, it will be important to assess project-level risks and devise suitable mitigation strategies."

Paul Donaghy, Head of Cost Consultancy – MENA

Egypt is forecast to record the strongest economic growth in the MENA region, with GDP predicted to grow by...

UAE construction activity is set to recover and grow over the next two years...



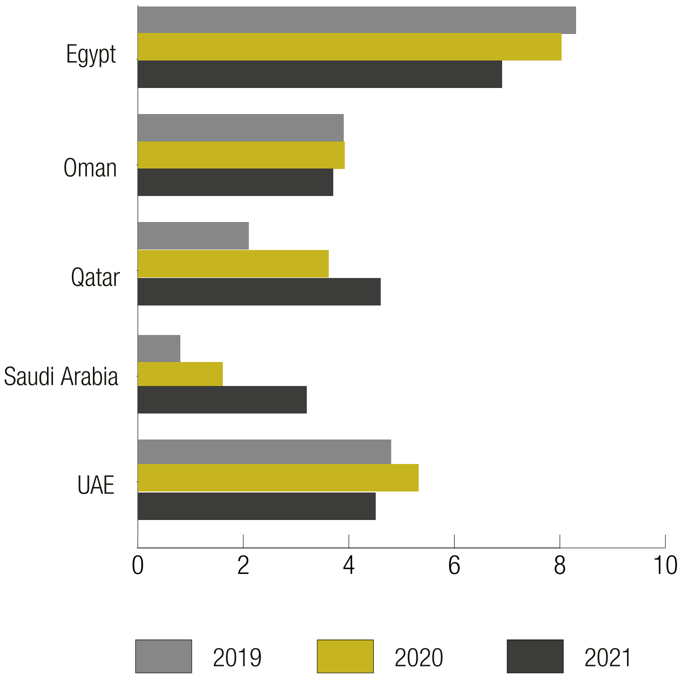
...but through to 2021 Egypt will experience the fastest construction output growth.

Oil prices continue to fluctuate around...

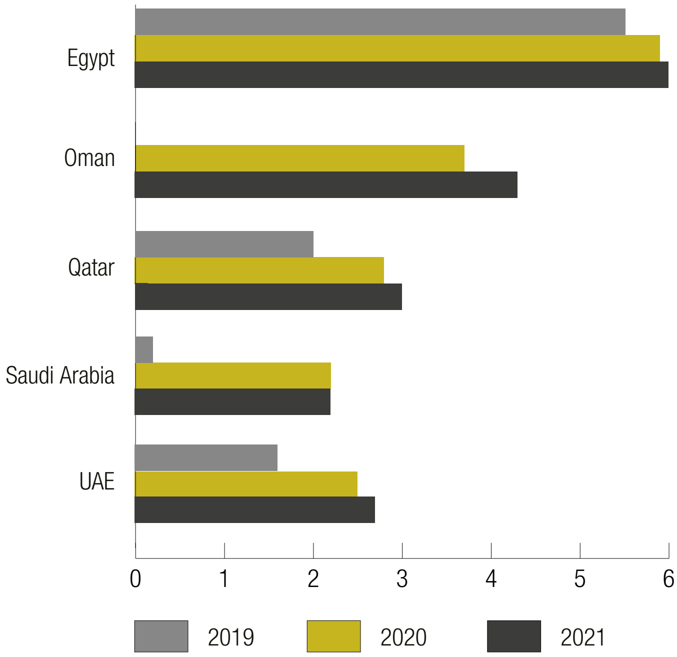
...but this time last year it was closer to...

With oil prices faltering, governments across MENA are looking towards a public-private partnership model for delivering public infrastructure and planned mega projects.

Construction output growth (real growth, % change)



GDP growth (real growth, % change)



REGIONAL OVERVIEW

Across MENA, economic headwinds have strengthened and the near-term outlook for growth remains relatively subdued. The IMF (International Monetary Fund) has downgraded its growth projection for 2019 by 0.9% since April to 1.3% - a moderate slowdown compared with 2018. Prospects for 2020 are better, with GDP expected to increase by 2.8%. The scale and longevity of the coronavirus outbreak will influence economic prosperity during 2020 and other significant downside risks - from simmering geopolitical tensions, slower global economic growth, and oil price volatility – may threaten stability.

Tentative signs that the two-year rift between Gulf Cooperation Council (GCC) states and Qatar may be easing have started to emerge. Commentators suggest confrontational social media campaigns have been scaled back and Saudi's national football team participated in the 24th Arabian Gulf Cup, hosted by Qatar, towards the end of 2019. Furthermore, Qatar's prime minister attended the annual GCC summit in Riyadh in December. It is early days but the process of rebuilding trust has begun and, if this continues it will have positive implications for the ease of doing business in the region.

Construction spending in the Middle East and Africa increased by 1.7% in 2018, with growth expected to accelerate to 2.4% in 2019 and 3.1% in 2020. The UAE and Saudi Arabia are the largest construction markets in the region.

Against a subdued global economic backdrop, demand for metals has reduced. World Bank data suggests that aluminium, copper and zinc prices were down by 15%, 7% and 8% respectively, year-on-year in October. Pricing in some metals markets continues to be influenced by earlier supply disruption. The tragic collapse of a dam at Brazil's Brumadinho mine in January 2019 drove annual inflation in the iron ore spot price to peak at 86% in July. Prices have since fallen but they remain over 20% higher on an annual basis. Indonesia's recent surprise decision to ban all exports of nickel ore from January 2020 was a further shock. As the world's second largest exporter of nickel ore – a key component in stainless steel production – this is a significant development that drove 38% year-on-year inflation in nickel prices in October.

Brent crude prices suffered their sharpest one-day fall since the financial crisis in early March. Saudi's unilateral decision to step up production, as fears mounted about the threat coronavirus presents to global oil demand, triggered a 27% price reduction on global markets. A prolonged period of low prices will present fiscal challenges for oil producing nations and has the potential to weigh on public spending and private sector investment. Oil related revenues account for over 40% of GDP in Saudi Arabia and a third in the UAE.

UNITED ARAB EMIRATES

Weak demand has plagued the UAE construction sector in recent years but the outlook is brighter. During the downturn, competition was intense and tender prices reduced sharply, even though the actual cost of delivering construction projects continued to rise. Procurement strategy in recovering markets should account for the risk of a shift in pricing behaviour as contractors seek to restore margins.

ECONOMY

Economic growth across the United Arab Emirates has been lacklustre in recent years, constrained by oil price weakness and private sector reticence. GDP grew by 1.7% in 2018 and the IMF's latest projection suggests 2019 is likely to be equally unremarkable. Looking ahead, the outlook is more positive. Expo 2020 in Dubai – expected to attract 25 million visitors – should provide a boost to non-oil activity and the impact of expansionary fiscal policy, introduced over the past 18 months, will build. The IMF expects GDP growth to accelerate to 2.5% in 2020 and 2.7% in 2021.

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October's UAE PMI was unchanged at 51.1. While a reading over 50 suggests growth, this level reflects a relatively subdued state of private sector demand in the UAE market. Faced with weak demand, several firms engaged in promotional activity, such as reducing selling prices, during the month. Input prices rose marginally for the second consecutive month.

CONSTRUCTION

It has been a challenging few years for the UAE's construction sector. Output declined in real terms in 2016 and 2017 but returned to modest growth in 2018. The overall outlook is brighter but risks continue to threaten. IHS Markit forecasts growth of 5.3% and 4.5% for 2020 and 2021 respectively as demand strengthens.

Residential property prices have been on a downwards trajectory since mid-2016. In September, prices in Dubai recorded an annualised, overall, fall of 7.3%, while in Abu Dhabi prices dropped by 7.7%, according to Oxford Economics. Oversupply is a problem, especially in Dubai, but price pressures also stem from the weakness of the labour market and demand resulting from the subdued state of the wider economy. Property agents expect prices to continue to decline in Q4 but note that the market appears to be bottoming out.

Data from Cavendish Maxwell paints an equally subdued picture of current commercial real estate market activity. Office rents in Dubai continued their descent in Q3 and in Abu Dhabi office rents declined by 2 to 3%, on a quarterly basis, as demand from oil and gas sector clients remained subdued. Sales incentives such as longer rent-free periods and flexible payment terms are becoming increasingly common, in addition to falls in headline rents.

Significant oversupply of residential and commercial property has weighed on market fundamentals in recent years. A Higher Real Estate Planning Committee has recently been established to regulate Dubai's real estate sector to alleviate the risk of this situation happening again. The Committee aims to ensure proposed developments will make a valuable contribution to the national economy, within the context of the wider agreed development pipeline. It is hoped this oversight will ultimately generate a better balance between supply and demand in Dubai's real estate markets going forward.

Data from the Federal Competitiveness and Statistics Authority suggests overall producer price inflation was running at an annual rate of circa 1.8% in Q1. Fabricated metal products rose by 11.6% over the same period.

KINGDOM OF SAUDI ARABIA

After the 2018 blip in construction sector activity, demand has stabilised, and the outlook is optimistic. The number and scale of proposed mega projects in the pipeline presents an upside risk to this relatively benign projection – but it is a question of finance. Oil prices remain depressed and the path to greater private sector involvement is slow.

ECONOMY

The IMF has significantly downgraded its forecast for economic growth in 2019. Higher government spending and buoyant business confidence will drive an upswing in non-oil activity but anticipated oil-related activity is now expected to decline on the back of the weakness of global oil demand and the extension of the OPEC+ agreement. GDP is now forecast to rise by just 0.2% in 2019. In 2020, the pace of increase is projected to accelerate to 2.2% as prospects for oil generate GDP recover. This pace of expansion is expected to be maintained in 2021.

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IHS Markit's PMI for Saudi Arabia's non-oil private sector rose to its highest level since August 2015. At 57.7 in October, the overall indicator suggests business conditions are buoyant and new orders growth quickened. Respondents also expressed optimism about the 12-month outlook.

CONSTRUCTION

2018 was a subdued year for construction activity. Output contracted by 3.1% during the year amid retrenchment in both residential and non-residential sectors as weaker oil prices placed pressure on public sector finances and government attention turned towards paying down debt. Having stabilised in 2019, the sector is poised to return to modest growth of 1.6% in 2020, before accelerating to 3.2% in 2021, according to IHS Markit.

Budget 2019 set out plans to increase state spending by 7% in an attempt to revive flagging economic momentum. From an actual of US$270bn in 2018, total spending in 2019 was planned to hit a record high of US$290bn.

Mega projects suggest a brighter outlook for construction. Neom, a 45 square kilometre planned smart city in the Tabuk Province of north-western Saudi Arabia will feature several thousand residential units along with supporting leisure, retail, commercial, public and entertainment space. A US$500bn allocation from the Public Investment Fund in early 2019 means phase one is on track to complete by 2025.

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For other ambitious projects, finance is proving more elusive. Pressure on government finances has increased in a lower oil price environment and privatisation is seen as a solution. The recent initial public offering of state-owned Saudi Aramco achieved a record US$25.6bn, despite being scaled back. This sale of a 1.5% of stake in the business marks the start of the Kingdom's journey to privatise state-owned assets. Riyadh has previously stated an ambition to raise more than US$10bn through selling government-controlled entities – such as the Kingdom's water desalination system – by 2020 but transactions are complex and progress has been slow.

Construction costs are generally rising slowly across the country due to strong inflation in some materials prices. Wholesale price indices, produced by Saudi's General Authority for Statistics, recorded a 9.6% annual change in fabricated metals products, while gypsum lime and cement prices rose by 7.2% in October.

QATAR

As large projects reach completion, capacity has come back on stream and the tendering environment has become more competitive. Work on several major new schemes is likely to be postponed until after the FIFA 2022 World Cup but, despite this, the near-term outlook for construction activity growth remains positive.

ECONOMY

Following its latest consultation, the IMF concluded that the Qatar economy has successfully negotiated the dual shocks of lower oil prices and the diplomatic rift. GDP growth strengthened to an estimated 2% in 2019 from 1.5% in 2018 and the outlook is relatively bright. GDP is forecast to expand by 2.8% in 2020 and 3% in 2021.

The latest Qatar Financial Centre PMI, covering the non-energy private sector economy, rose to 48.3 but continued to fall short of 50 – the level indicating a stable activity level. Overall this suggests business conditions are strained but new orders indices have improved suggesting a positive outlook over the next 12 months.

National Vision 2030 presents a long-term strategic roadmap to transform Qatar into a highly prosperous, independent nation

National Vision 2030, launched in 2008, presents a long-term strategic roadmap to transform Qatar into a highly prosperous, independent nation in a controlled way underpinned by economic and social development and environmental management. Economic diversification to gradually reduce reliance on hydrocarbon industries is an important strand.

CONSTRUCTION

Construction output recorded six years of double-digit growth through to 2018 amid significant infrastructure investment and preparations for FIFA 2022. Relative to this, industry prospects in 2019 have been lacklustre. IHS Markit expects construction output growth to slow to 2.1% this year. Growth is forecast to strengthen to 3.6% in 2020 and 4.6% in 2021.

Overall, the proposed project pipeline is healthy but several schemes remain on hold. MEED Projects reports that the pipeline of known, planned and unawarded projects in Qatar totals US$91.7bn. Planned investment to increase LNG production capacity by 64% over the next seven years will provide a significant boost and work on the Hamad International Airport expansion is progressing at pace. Other sizeable projects – such as the Sharq Crossing – wait in the wings but, as the country prepares to host the 2022 FIFA World Cup, appetite to press ahead with larger projects is likely to be limited.

Major projects expenditure by the government contracted by 3.6% in 2019 as a couple of major infrastructure schemes reached completion. Budget 2019 allocated US$3.3bn

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to develop new housing for Qatari nationals and suggested that new projects with a total cost of US$13.2bn are expected to be awarded out of a portfolio of committed projects worth US$115.6bn. Included within this are five new health centres, two new schools for the Qatar Academy, plus other new schools with a total cost of US$1.9bn over five years.

Earlier this year the Cabinet approved new laws to support greater public-private cooperation in project delivery and to allow up to 100% foreign ownership in all economic and trade activities. A public-private partnership pilot framework, for the construction of 45 public sector schools worth an estimated US$1.1bn, has been launched and early negotiations are underway. Success will hinge on the ability to find an appropriate risk balance.

Real estate indicators remain subdued. Analysts report that rents and capital values continue to fall and a significant amount of new supply will come on stream over the next 18 months. According to DTZ, residential and office space under construction will increase capacity by 50% and 40% respectively over the next three years which poses a further downside risk to asset prices.

Producer price inflation in the manufacturing sector decreased by 0.4%, month-on-month, in September 2019. On an annual basis, the overall index recorded a 6.9% decrease in prices, driven by falls in prices of refined petroleum products, basic metals and cement and other non-metallic products.

OMAN

With the Government's focus firmly on debt reduction, the near-term outlook for construction is subdued. Over the medium term, the project pipeline is expected to increase, providing a boost to the construction sector.

ECONOMY

Oman's economy stagnated in 2019 according to the IMF as austerity took hold and oil revenues fell short of expectation. The outlook for 2020 is stronger, driven by an anticipated increase in oil production. GDP is forecast to increase by 3.7% in 2020 and 4.3% in 2021.

Fiscal consolidation has helped reduce the government deficit to 6.7% of GDP – from a peak of 21.3% in 2016 – but the current account remains in deficit and debt continues to mount. Total government gross debt as a percentage of GDP is expected to hit 60% in 2019, rising to 64% in 2020.

The IMF's latest review of Oman's economy suggests a deeper fiscal adjustment is required, in addition to measures already taken and continued progress with structural reform towards economic diversification, to ensure external confidence is maintained. Measures called for include the swift introduction of VAT and a reduction in government expenditure.

CONSTRUCTION

Construction output increased by 3.7% in 2018, according to IHS Markit. Growth in residential activity helped to offset the weakness of the commercial construction sector. Output growth accelerated modestly in 2019 to 3.9% and this pace of growth is expected to be sustained in 2020. Infrastructure, accounting for nearly 40% of industry activity, will support future industry expansion as work commences on several roads projects.

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Projects in the pipeline, yet to be awarded, have a collective value of US$45.7bn according to MEED Projects. The precarious state of government finances may weigh on project starts and it is unlikely that all of these schemes will progress.

EGYPT

Egypt's economy is storming ahead and the construction sector is in the midst of a development boom. Contractor capacity is stretched and some materials are in short supply. Together these factors are influencing contractors pricing decisions and procurement strategy should attempt to mitigate this. Early, tenacious, supply chain engagement can help to deliver value.

ECONOMY

The successful execution of a macroeconomic reform programme to bring debt under control, boost employment and stimulate growth, helped generate GDP growth of 5.3% in 2018. In July, the IMF Executive Board concluded its latest review of the Extended Fund Facility by stating that on the back of reform made to date, the economic outlook is positive. Latest forecasts from the organisation suggest that GDP will increase by 5.9% in 2020 and 6% in 2021.

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In 2018/19 the public debt-to-GDP ratio improved as the 2% surplus target was achieved. That said, total government debt was estimated to amount to nearly 85% of GDP in 2019 – a relatively high level for a country in the MENA region.

Recent survey data paints a subdued picture of the state of the private sector. The headline IHS Markit Egypt PMI dipped to 49.2 in October. While this is only marginally in declining territory, the measure has hovered below the 50 – no change threshold – largely since mid-2018. Respondents reported lower sales, liquidity problems and subdued demand. Input cost inflation dropped to its weakest level since June.

CONSTRUCTION

Against a robust economic backdrop, Egypt's construction sector expanded by 9.6% in 2018 according to IHS Markit. Infrastructure, accounting for 58% of total construction activity, expanded by 10.6% and is forecast to continue to make a robust contribution to growth over the next two years. In contrast, the pace of growth in residential and commercial construction sectors is forecast to moderate. Overall, after increasing by an estimated 8.3% in 2019, construction activity is forecast to grow by 8% in 2020 and 6.9% in 2021.

JLL anticipates that a further 156,000 square metres of new office gross lettable area will complete in Cairo next year. Office rents in central and eastern parts of the city have remained stable over the past year. Housing market fundamentals are also stable in the city. Sales prices in the secondary market were relatively positive during Q2. New supply in 2020 is expected to total 46,700 units.

MEED Projects report that Egypt is the second largest projects market in the region, after the UAE. Projects with a total value of US$116bn, that have yet to be awarded, are currently in the pipeline across the power, construction and transportation sectors. Most of these are in feasibility and design stages. Contracts totalling more than US$14.2bn have been awarded in phase one of the New El Alamein City, located on the north coast. The new city will eventually accommodate more than three million people.

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