MENA MARKET VIEW

H1 2022
Mace Consult

Foreword

The first half of 2022 has been buoyant, with market demand picking up speed in two of our key Middle Eastern regions: United Arab Emirates (UAE) and Kingdom of Saudi Arabia (KSA).

It has been particularly positive to observe significant new opportunities come to market after a period of relative quietness in the UAE. This increase in activity is clearly aligned to a surging oil price and with a sustained price above $100/barrel, all our main Middle Eastern markets are likely to realise budget surpluses in 2022, boding well for capital works investment in upcoming years.

Set against this backdrop, however, there are also headwinds and increased risks to consider; ongoing supply issues caused by the Covid-19 pandemic, combined with the effects of the conflict between Russia and the Ukraine have driven global commodity prices sky high.

In KSA, propelled by market demand, we observed tender price inflation of 8.1% in 2021. Based on the market context provided in this report, with ongoing demand and further material inflation, we expect tender prices for 2022 to increase by 7% to 7.5%.

For the UAE, with flat tender price inflation being observed for many years, we are now expecting to see 2022 pickup, resulting in an annual average of 1.5% to 2%. With rising tender prices, project viability will always be under threat.

In this market view, we aim to provide some economic context for the main Middle East and North Africa regions in which Mace Consult operates. We trust that you will find it insightful.

Steve Gee

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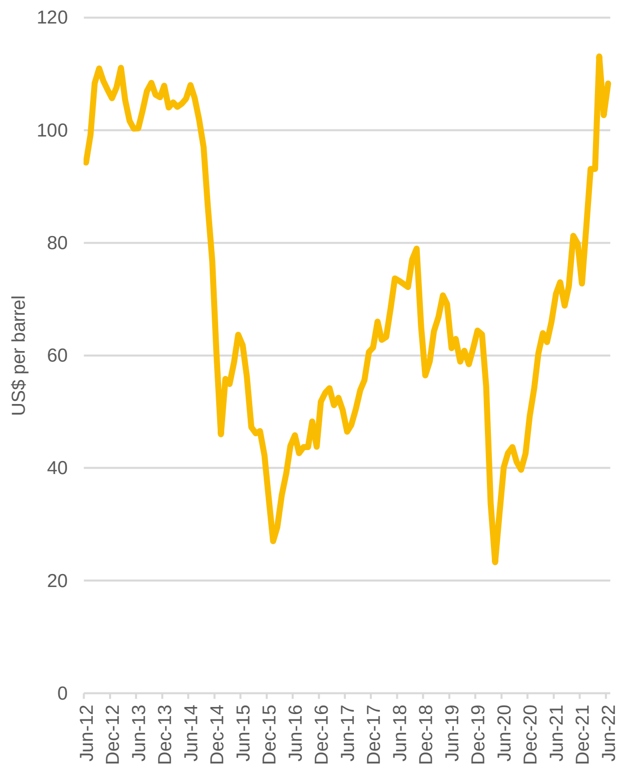
Introduction

A number of themes are common across the Middle East and North Africa and each country's construction industry can expect to feel their effects. Firstly, oil prices were rising even before the start of the Ukraine crisis but following Russia's invasion in February, they have pushed sharply higher. Similarly, natural gas prices have shot-up and inflation in the region will also rise as a result. Just as importantly, it will benefit those countries which are large exporters of these products. Partly as a result, the IMF have upgraded their GDP forecasts for both Saudi Arabia and the UAE. Faster growth will help support the construction industry, although its growth won't keep up with the hydrocarbon economy.

Nonetheless, oil isn't the only commodity hit by the crisis and forecasts for global metals, notably aluminium and copper, indicate prices will also be higher on average than they were in 2021. In addition, even where prices may fall, they are likely to be noticeably higher than in 2020, which is what Oxford Economics are forecasting with steel prices. With Chinese steel, where the majority of the region's imports come from, forecast to see only minimal reductions even by 2025, many large projects may need to manage other costs more carefully.

The problem of higher inflation is clearly not specific to the MENA region, but that it is set to be much higher in the US will have significant knock-on effects domestically. Notably, many countries, including Saudi Arabia and the UAE are pegged to the dollar. As such, when the Federal Reserve chooses to raise interest rates, their central banks typically follow suit. This already happened in March and is likely to occur multiple times again in the year, with some forecasters suggesting bases rates may rise from 0.25% in January to potentially over 2% by the end of the year. Higher interest rates pose a particular problem for construction projects, many of which are dependent on considerable amounts of financing. With credit more expensive, in some cases viability assessments will need to be re-run, potentially delaying new schemes.

Figure 1: Oil Prices



Source: World Bank

Figure 2: CPI Inflation

Source: IMF World Economic Outlook

United Arab Emirates

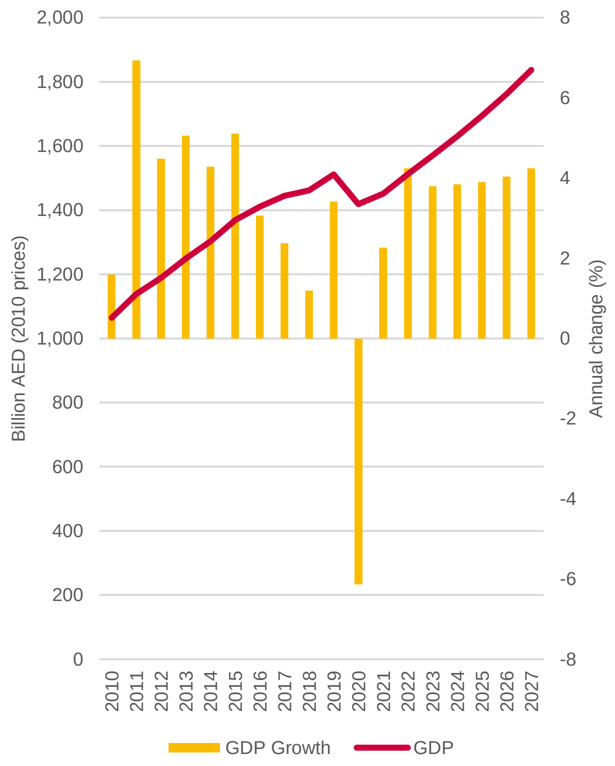
The UAE economy struggled during the pandemic. This was in part due to a reliance on the petroleum sector, while also having a fairly large travel and tourism industry. With some Covid restrictions in place earlier in the year, even with Expo 2020 encouraging visitors to return, the recovery has so far been modest. Estimates suggest the economy was still smaller at the end of 2021 than in Q4 2019 meaning it has had one of the weakest recoveries seen in the MENA region. Prospects for this year look better, but highlighting the stunted recovery, this will only take GDP back to 2019's level. Further ahead, the IMF forecasts GDP growth will average 4%, slightly above the average rate seen in the 2010s.

Oil and natural gas are the country's most important industries and with the price of crude oil now well above US$100 a barrel, the hydrocarbon sector is forecast to drive growth over the next couple of years. The March PMI also indicates that the non-hydrocarbon economy is continuing to rebound, albeit with higher inflation starting to have an effect.

This year will be another one where inflation is a major problem for construction even if the headline figure for last year doesn't instantly give that impression. Data from Dubai shows that in 2021, the annual percentage change in the construction cost index was just 1.9%. Unfortunately, there is no data on construction prices across the whole country, but it is likely to have been higher. In terms of consumer prices Dubai was clearly weaker than the wider UAE and whereas in Dubai, CPI inflation declined 2.2% last year, for the UAE it rose 0.2%. Therefore, for both the UAE as a whole, and Dubai in particular, inflation in 2021 was much weaker than the vast majority of countries, either in the Middle East or further afield.

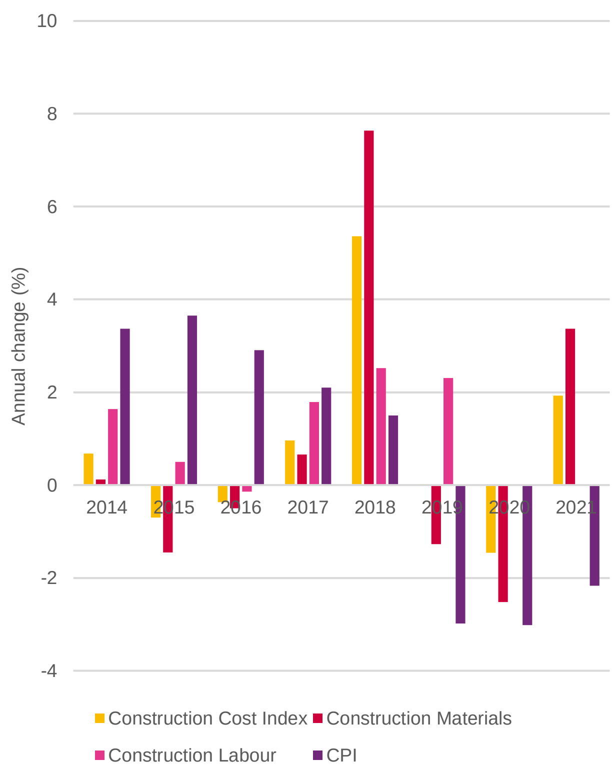
While the headline figure was just 1.9%, this masks a number of much larger changes in the constituent parts. In particular, basic metals rose by over 30%, and there were also sizeable increases in refined petroleum products, rubber and plastics and electrical equipment. Many of the inputs into these

Figure 3: GDP



Source: IMF World Economic Outlook

Figure 4: Dubai Construction Costs



Source: Dubai Statistics Center

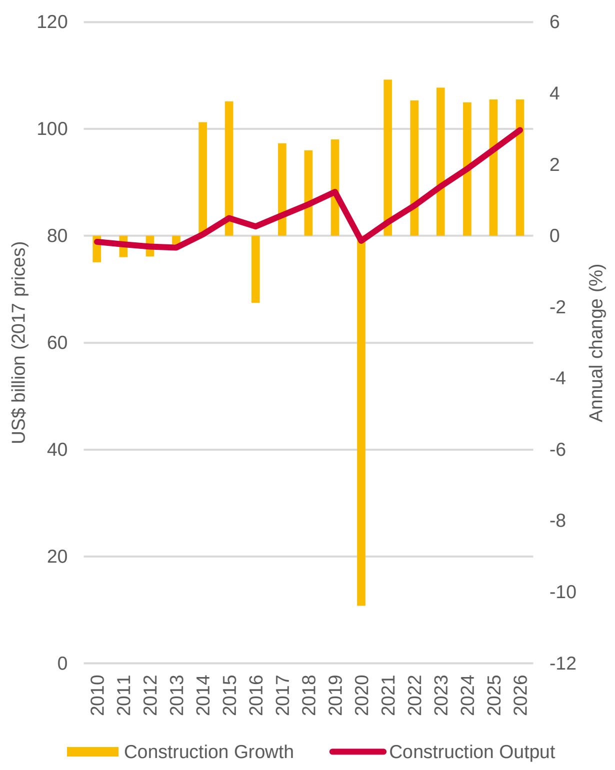
categories are likely to be higher again this year, as supply chain problems ease slowly and the Ukraine crisis increases the cost of energy and transport.

Such large changes in some key products mean we have a bit of scepticism that material prices only rose 3.4% last year, but more importantly, with regards to helping keep overall inflation down was labour costs. These were virtually unchanged in 2021 and are less than 9% higher than in 2013. The majority of workers in the industry are expatriates and Covid does pose questions about whether this low rate of wage inflation is sustainable. With restrictions on travel, and likely more workers than usual having returned home, a smaller workforce could push up wages. More generally, unemployment in the UAE is very low and while it unsurprisingly spiked in 2020, and is still higher than it was, it remains very low by regional standards. The March PMI also highlighted how higher labour costs were hindering hiring.

The construction sector suffered more than the wider economy during the pandemic; whereas GDP dropped 6.1%, construction output fell by more than 10%. Having had such a large decline, it will take an extra year for output to get back to its 2019 level according to MEED. Over the next five years, MEED expects construction output growth to average 3.9% while IHS Markit is expecting it to be marginally lower at 3.3%. Both organisations therefore expect it to be robust, albeit slightly lower than GDP growth.

Due to several large projects, including the Mina Rashid Redevelopment and Hartland Sanctuary, likely to be at their most active in 2024 and 2025, MEED's forecast for construction cashflow in these years is already near previous levels. As new projects come to light, forecast cashflow is likely to rise further and alongside the wider economic strength, upside potential exists for the construction industry in the coming years. One further factor which could support construction is a reversal in house prices. These had been falling for a number of years pre-pandemic but are now likely to rise slowly over the next decade, helping support housebuilding.

Figure 5: Construction Output



Source: MEED

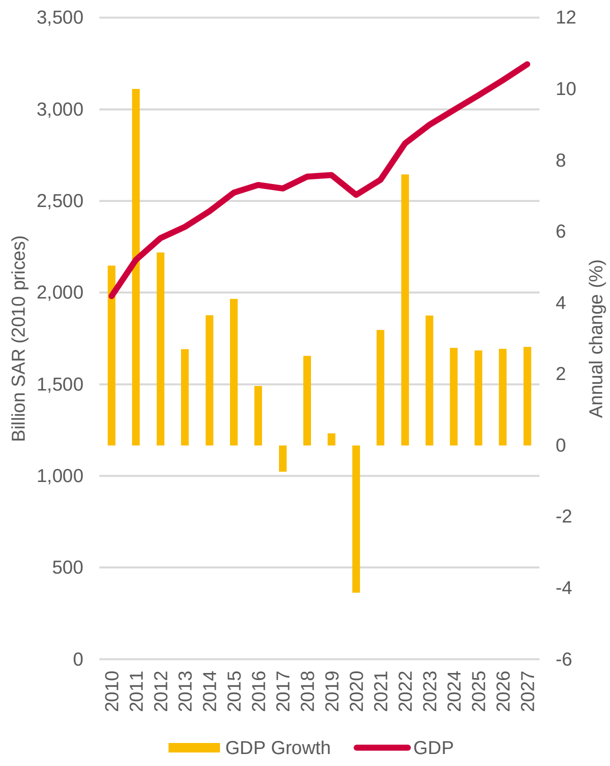
Kingdom of Saudi Arabia

The size of Saudi Arabia's economy will surpass 2019's level this year, helped by a double-digit growth rate in the oil sector. Alongside higher prices, decisions by Opec+ to reverse previous production cuts will lead to a substantial increase in receipts. Whereas in 2021, average production of oil was 9.1 million barrels per day, in March 2022, this had risen to 10.3 mb/d and further steady increases will take place throughout the year. As a result of this, the World Bank is forecasting Saudi Arabia will have its first budget surplus in nine years in 2022.

Such an improvement in the outlook will allow the government to invest in a number of new, large construction projects. Based on project data from MEED, one of the most notable ones is a US$20bn Ministry of Housing scheme. The Dahiyat Al-Fursan project had been on hold for several years but in August 2021, it was revived with the aim of finding a developer who could help build 35,000 houses. In total, over 15 years, the project could deliver 100,000 properties as well as a Mega mall, football stadium and Grand Mosque. Other multi-billion-dollar projects which could commence in the next few years include the Jeddah Central Project, the Jabal Al Sharashif Development and the Red Sea Tourism project. Furthermore, there are plans for a number of large transport projects including a new airport in the Asir region, a metro scheme in Dammam and a port expansion in Jeddah. With so many ambitious schemes in the pipeline, it is not surprising that forecasts for construction cashflow in 2024 and 2025 are at record levels and would be more than double the previous high seen in 2016.

Nonetheless, based on forecasts for construction output growth, there are clearly some doubts that all of these projects will take place, certainly within current timelines. While MEED are forecasting that output growth will peak in 2024, the rate will only reach 4.5%. Over the next 5 years, they expect the compound rate of growth to be just below 4%. Though a robust rate, it is someway short of the levels the cashflow forecasts suggest.

Figure 6: GDP



Source: IMF World Economic Outlook

Figure 7: Materials

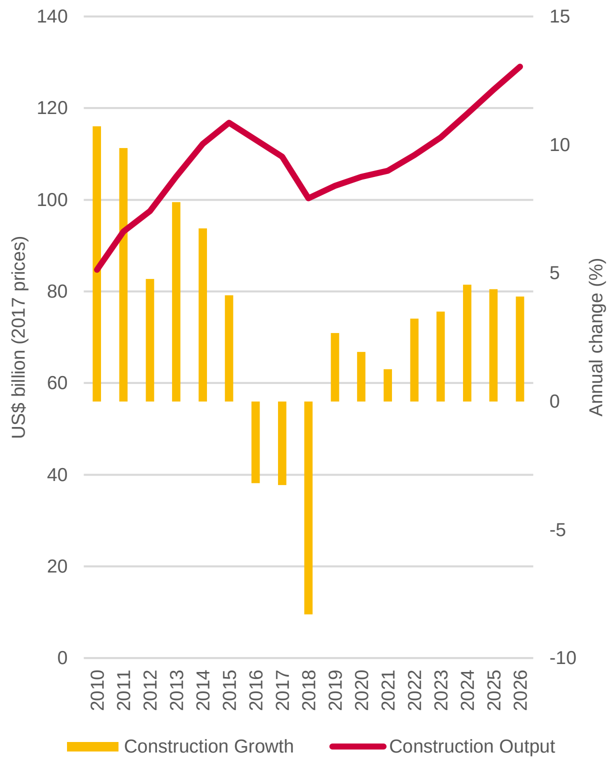
Source: GASTAT

Saudi Arabia's large oil sector may mean that it is one of the biggest beneficiaries of rising prices, but even a generous subsidy policy won't fully insulate it from inflation. Last year, there were record inflation levels for timber and cabling, while iron, bricks and concrete prices also surged. For timber and cabling, these price pressures have continued at the start of the year. Whereas it appears likely Saudi Arabia experiences a modest rate of CPI in 2022, its construction material price inflation will be more pronounced.

There was an increase in the number of people working in construction for the first time since the pandemic in the final quarter of 2021. Nonetheless, since Q4 2019, the number of people in the industry has fallen by almost 200,000. Given over 90% of the industry is expatriate labour, it is unsurprising that this is where most of the change has come from. Yet with over 10% fewer expatriate workers than two years ago, as the industry continues to rebound, if these workers have left the country for good, growth may stall.

The biggest risk to strong growth in the coming years is if oil prices were to fall back. Given the Ukraine crisis, such a scenario currently seems doubtful. However, with parts of the global economy looking likely to go through a period of stagflation, and the potential for recessions to follow, demand for oil may weaken and in turn prices could drop. The Vision-2030 strategy is all about diversifying the economy and making it more resilient while at the same time reducing its dependence on oil. For the time being, this is very much a work in progress, and it is clearly not there yet, meaning that the price of oil still has a significant effect. Highlighting how quickly a shift in price can change conditions, in October the IMF were forecasting that GDP growth this year would be 4.8% while they now expect it to top 7.5%. Also in October, the World Bank were predicting the government would be running a deficit both this year and next, whereas they now anticipate strong surpluses. If the global economy cannot sustain oil prices over US$100 a barrel, then forecasts for construction growth in Saudi Arabia will need adjusting down.

Figure 8: Construction Output



Source: MEED

Egypt

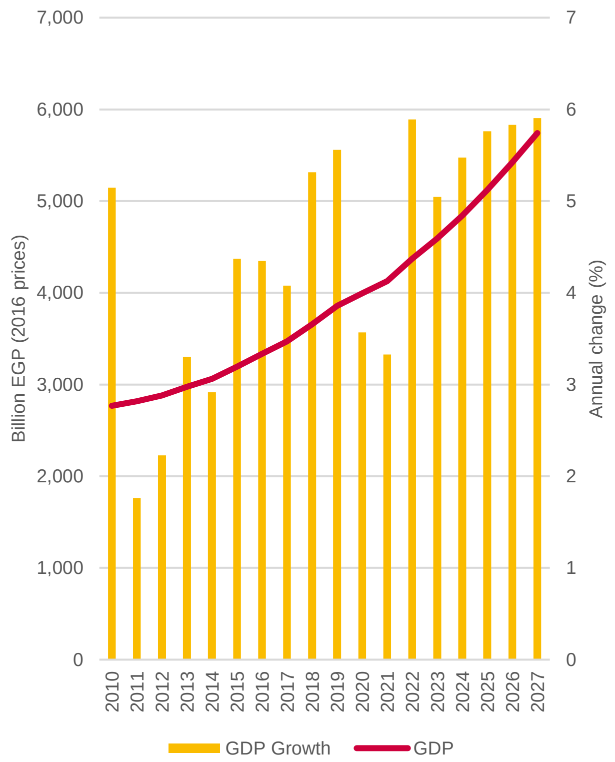
Egypt was one of the few countries where GDP grew in 2020. While exports and the tourism industry struggled, household and government spending were surprisingly strong. This year, the IMF expects GDP growth of 5.9%, possibly a more optimistic interpretation of the economy than given by the March PMI survey. Here, businesses reported that activity and new orders were falling, and confidence was at a record low with rapidly rising prices a major issue.

On March 21st, the Central Bank of Egypt attempted to curb the problem of rising prices. In a special meeting, the Monetary Policy Committee decided to raise interest rates to 9.75%. Given annual CPI inflation jumped from 8.8% in February to 12.1% in March, it is easy to see why the Central Bank is concerned about rising prices. While their target inflation rate of 7% is much higher than in developed economies, double-digit price rises are likely to prove problematic for a country with almost 30% of the population in poverty. In particular, food price inflation currently stands just below 20%, and discretionary spending is likely to suffer. In their April forecast the IMF predicted average inflation this year would be 7.5% suggesting a significant easing in the latter half of 2022.

For construction, the 14% depreciation in the currency that followed the MPC's decision won't help those in the industry reliant on imports. Similarly, higher energy costs will inevitably increase prices of energy intensive products such as cement, glass and steel.

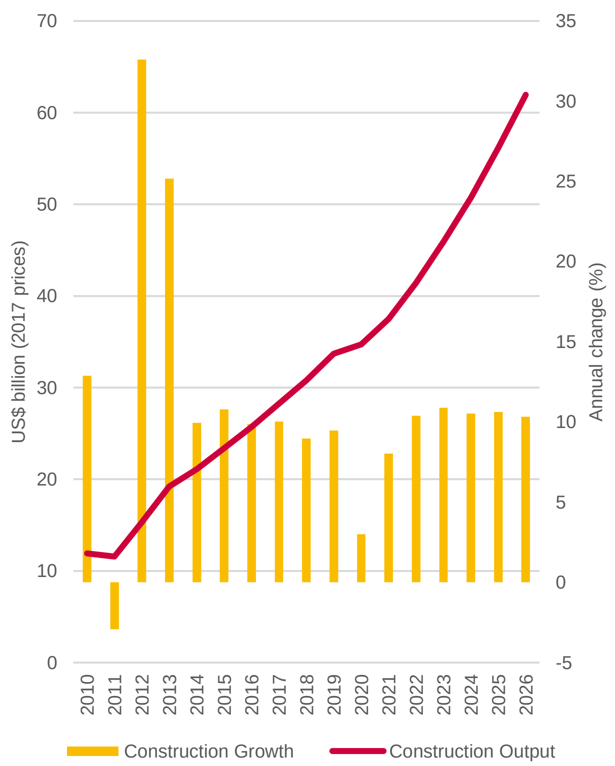
In spite of rising interest rates and inflation, MEED are forecasting very strong construction output growth over the next five years. In each year, from now to 2026, construction output, in real dollar terms, is forecast to be over 10%. One factor helping growth are Phases 2 and 3 of the High Speed Rail Network which according to MEED have a combined value of US$11bn. In addition, the residential sector will see solid expansion with a rising population and number of households. Nonetheless, further increases in interest rates or prices could both act as a deterrent to activity and slow construction growth.

Figure 9: GDP



Source: IMF World Economic Outlook

Figure 10: Construction Output



Source: MEED

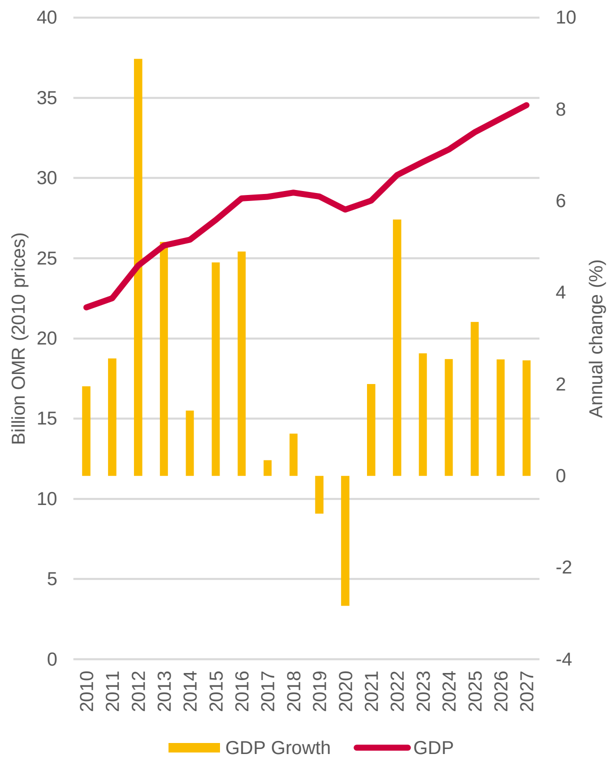
Oman

Having failed to adapt to lower oil prices, the Omani economy was going through a difficult period before the pandemic. Following a fairly modest 2.8% decline in GDP in 2020, the economy did rebound with 2% growth last year. With substantial support from the hydrocarbon sector, the IMF is forecasting the economy will grow 5.6% this year, which would be its fastest growth rate since 2012. As well as higher oil prices, higher production will also provide an impetus. Looking slightly further ahead, growth in most of the following years will hover a little bit above 3.5%. Along with support from the oil sector, structural reforms such as cutting subsidies and the introduction of VAT will change the make-up of the economy.

As elsewhere, inflation in Oman is a concern. In 2021, the producer price index rose 15.3%, albeit this only took prices back to the level seen in 2019. However, while some construction products were rising rapidly, most notably steel and aluminium, others were falling in price at the end of last year. In particular, cement, lime & plaster in Q4 2021 was 4.2% lower than in Q4 2020 and glass, cement & marble products had fallen 0.8% over the same period. Given many of these products are very energy intensive, it is doubtful that this trend will persist. It also highlights the importance of understanding all the packages within a construction project and not simply focusing on headline figures.

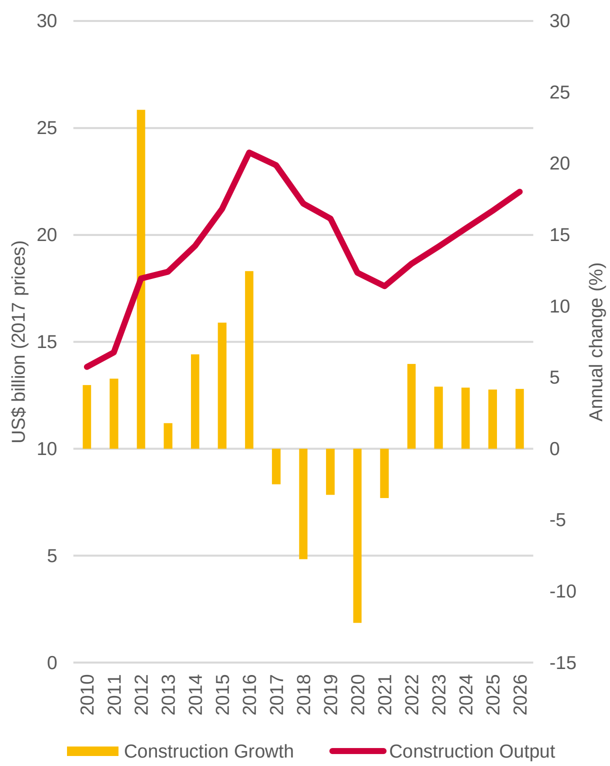
MEED data shows Oman's construction industry was one of the worst hit within MENA in 2020. They also estimate that output fell again in 2021, as both the residential and non-residential sectors struggled. Having also had problems in the years before the pandemic, it means the industry was over 25% smaller than in 2015. With such a large decline, output won't have made a full recovery by the end of MEED's forecast period in 2026. However, over the next five years growth should be strong, with the forecast for the compound annual average growth rate to be around 4.6%. Primarily driven by the energy sector, higher oil and gas prices will help support these projects' viability.

Figure 11: GDP



Source: IMF World Economic Outlook

Figure 12: Construction Output



Source: MEED

Qatar

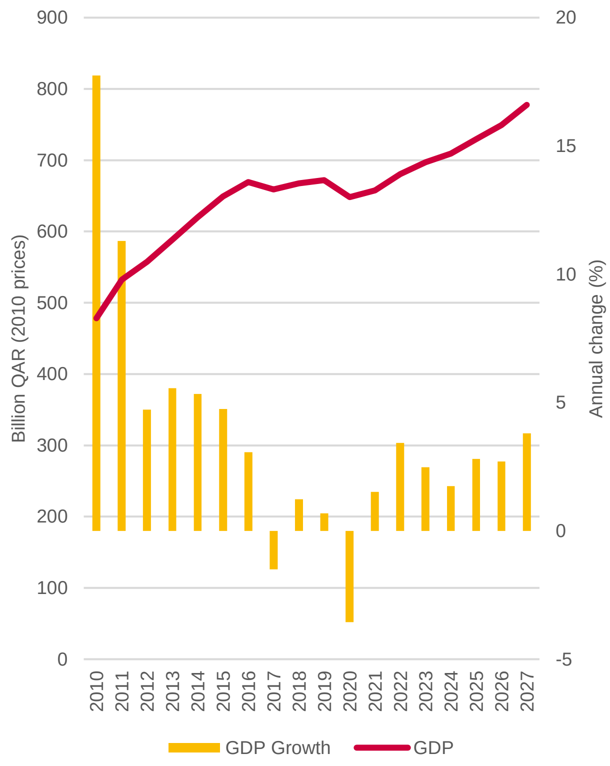
Of the five countries we analyse in this report, over the next five years, Qatar is forecast to see the weakest growth both with regards to GDP and construction output. While natural gas prices have risen, Qatar is unable to increase production in the same way other countries can export more oil. Plans for a US$29 billion investment in the North Field will improve capacity, as well as boost the construction the sector, but it will be several years before it leads to an increase in production. The IMF is forecasting growth of 3.4% this year, helped by the World Cup, but it won't surpass 3% again until 2027. These forecasts are significantly lower than the World Bank who are predicting GDP will be over 4% in each of the next three years.

The more optimistic forecasts would undoubtedly be better for the construction industry. They are also more inline with the March PMI survey, which was the third highest on record. New orders and output were both very high, while employment rose for the eighteenth successive month. This strength was in spite of rising prices.

In March, the annual inflation of the producer price index was running at almost 70%. This follows an 8.9% month-on-month increase in prices and includes large rises in both the manufacture of cement & other non-metallic mineral products as well as the manufacture of basic metals. However, with the former rising 15.6% and the latter going up by 33.7%, the two categories most relevant for construction are experiencing less severe inflation than the broader index.

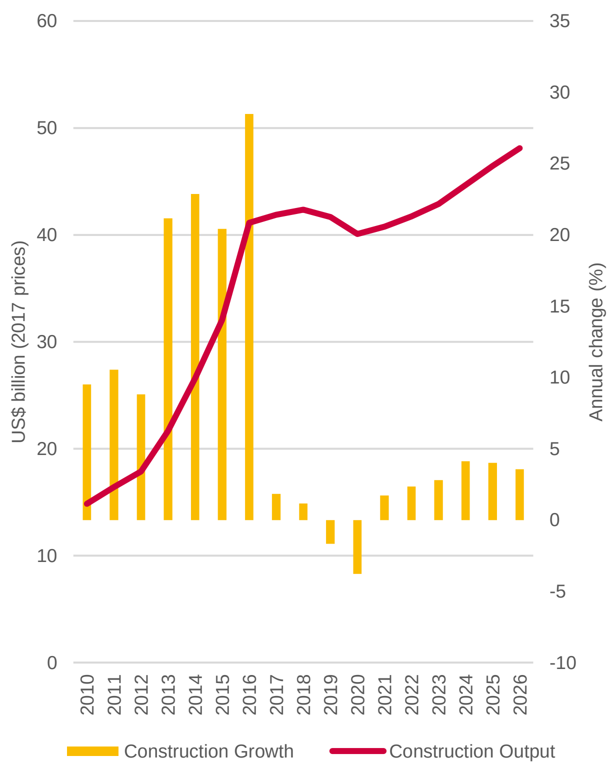
The North Field project will be one key driver for construction growth and is due to finish in 2027. With such large growth over the previous decade, including many infrastructure projects improving the country and getting ready for the World Cup, it is possibly unsurprising that growth will be more modest over the next decade. With Europe aiming to use much less Russian gas, there may be some upside risks to these forecasts if Qatar aims to increase production capacity further.

Figure 13: GDP



Source: IMF World Economic Outlook

Figure 14: Construction Output



Source: MEED

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