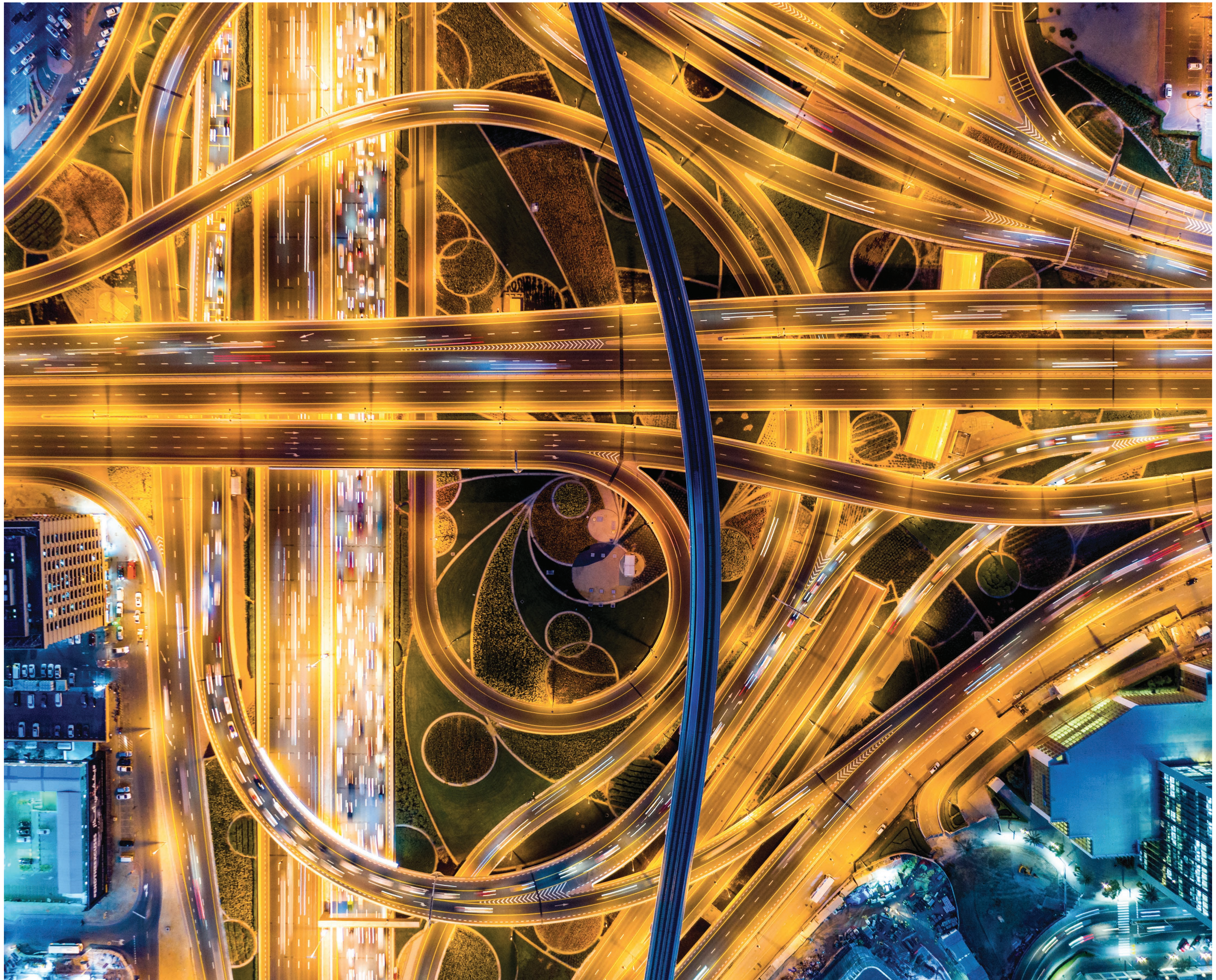


UAE Market - A Path to Recovery?

David Clifton, Vice President - Business Development, Hill International (Middle East) reviews the economic opportunities and constraints

In contrast with the other major regional market - Saudi Arabia - UAE has a more muted pipeline of opportunities for the industry. Although it could be argued that they are perhaps more realistic. However, should KSA keep progress with the awards schedules it has set itself, we will find an industry in the strange supply and demand situation where KSA has plenty of work but not enough supply chain partners and the UAE market the inverse, even through the international contractors have left, local capacity remains in surplus. Certainly, in the short term at least.

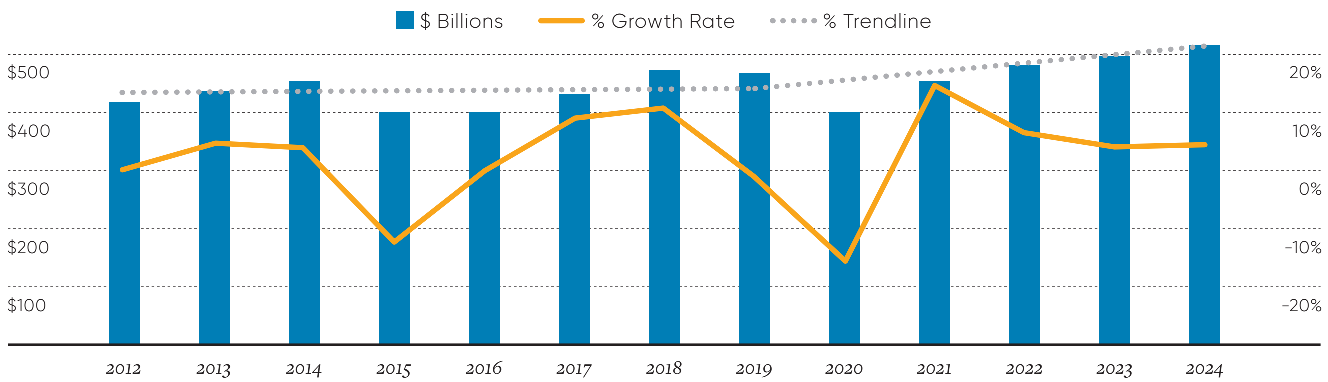
With the war in Ukraine, whilst impacting inflation significantly in country (as well as regionally and globally), this has provided the UAE with the opportunity to strengthen its global position politically, whilst also re-enforcing its reputation as an emerging markets safe haven, enabling a 'flight to safety' of capital. This has been a significant driver in off-plan real estate sales in 2022, supporting primarily the residential house builders.

With a budget-assumed oil price of US $64 per barrel and an average daily production of 3.2mn barrels, UAE with prices trending at c.$120 per barrel is operating an extra (notional) $180mn per day in revenue. Given the expected infrastructure stimulus as part of the pandemic recovery package not as yet on the ground, it is reasonable to expect a 'beefing up' of planned internal investment into the country. What should also be expected is an increase in regional support spending through the likes of Abu Dhabi Fund for Development (and others), as the country seeks to provide support for poorer countries and maintain political stability – as can be seen by the UAE/Egypt/Jordan industrial agreement recently. This will present the industry with opportunities at a regional level, backed by clients that typically are known to the markets.

With UAE having a reasonably diversified economy, the impact of the oil price spike, whilst significant, has been less of a hike on GDP than other regional economies. However, the country is expected to have an uprated GDP position with 5.5% of growth in 2022 before a level of 'normal' returns of c.4% in 2023 and 2024.

The UAE is expected to continue aggressively with its economic diversification policies and the extra revenue from the oil prices will only help support this. Although the attraction of new industries will also present the industry with opportunities. In many instances, the required infrastructure in not partially or fully in place, meaning the government will likely 'catalyse' the development of this to an extent.

United Arab Emirates GDP, 2012-2024



Turning to the industry performance and the future, we can see that 'bumps in the road' might be somewhat of an understatement in the past few years. Since the nadir of 2012-2014, we've seen a contraction of awards in the country. This has led to a continuing shrinking of backlog in the market. We have also seen the market awarding less and less technically challenging projects compared to that time period (acknowledging many complex projects were awarded). Looking at awards versus completions, we see that completions outnumbered awards by an average of 20% from 2016-2021. This has meant that even though materials have seen price input inflation that drove an overall increase, prices in general have declined for contract awards. However, due to the significant prices pressures, inflation has been pent up, the industry has seen c.9% inflation year to date. Whilst this has calmed, there is still to be expected a 'normal' level of inflation for the rest of the year.

With AED pegged to USD, some risk is being mildly offset in the global supply chain. With somewhat strong USA growth and forecast rate rises, the USD is expected to maintain and potentially increase in strength in the short term. This will make international procurement cheaper in non-dollar denominated nor pegged currencies which should have a level of balance in future inflation.

With awards expected to continue on a recovery through 2022 and continue their trajectory in 2023/24 due to the economic recovery in the region, increased oil revenue, flight to safety capital and the diversification policies, we can expect to see the inversion of the last few years of backlog burn outpacing new awards - the difficulty will be what these schemes look like as complexity and scale will dictate the supply chain models moving forward. The question is what the growth will look like? It is highly unlikely to be akin to the boom of 2005/8 or 2012-2014, but reassuring confidence has been injected into the sector with certain recent announcements, such as the next stage of Etihad Rail and ADNOC's continued investment plan in primarily downstream activities.

When we look at material price inflation, we see significant divergences between local (and regional) and international product price points - although this should be caveated in 2022 around the international as a lot is dependent on energy input prices - with international products such as steel and copper having seen spikes of 73% in 2021, before cooling off, only to see a 33% one month rise on the Ukraine war commencing. Locally sourced material has been dampened to a more normal level of 2-3% as the government and the industry have a greater level of influence in the markets. There is in this instance a strong argument for more localisation, the like of which we haven't seen to date. This goes against the globalisation argument, but most other global markets are retrenching due to geopolitical risk, although localisation has historically been a part of UAE planning (e.g., ADNOC ICV scores).

Moving forward: We're seeing a push towards alternative finance (PPP and similar), although with the rising cost of capital expected to yield a further 3-4 interest rate hike this year (which although impacting mortgage rates, a large quantum of assets are being purchased in cash) from the Federal Reserve in the USA (UAE Dirham is pegged to the USD – so USA interest rate is UAE's), many of these proposed schemes will struggle without major government usage guarantees (remembering that initial PPP finance is typically 5-7 years, which is likely the cycle we are in), as the interest rate will be remaining for a reasonable period, whilst Quantative Easing (QE) is tapered and inflation runs too high for most central banks policy remits.

For the industry, the cost of capital is a major issue (as with other industries) - the pandemic created a supply side imbalance as demand in most sectors doesn't yet outstrip pre-pandemic levels - which makes growing back more expensive and thus drives output price inflation due to financing. Furthermore, project working capital costs can now easily run over the profit margin on the contract. This will add further pressure to balance sheets and price points.

Problematically, as we start to see a recovery, the words 'bankruptcy beware' come into play. The industry prices in general as lump sum contracts. As the market has gone down over the last few years, this becomes a chase to the bottom. On the turn of the market (for whatever reason that may be), lump sum contracts are likely to be unstainable and pricing contracts moving forward for those that are viable businesses will overshoot the price of the moderated market (markets almost always overshoot one way or another). Market consolidation and bankruptcy should be expected.

On the positive levels, the confirmed ADNOC investments in downstream and the continued strength in real estate investment, as well as the expected infrastructure stimulus are all good news for a beleaguered industry from the last few years. No one expects the journey to be easy, but the targeted money the government is expected to deploy, should get the industry on a more sustainable footing again. Ideally minimising the peaks and troughs that emerging economies are so well known for.

Future Industry Movements

As we've seen a move away from the quantum of complexity in the building and infrastructure projects in the country, we've also seen a level of 'brain drain' to other markets, most notably Saudi Arabia. UAE has downgraded a lot of skill sets available in the market, based on project demand though. However, whilst the last five years has seen 'one way traffic' to Saudi Arabia, the upcoming investments are starting to see this trend must (and in some instances will) see a return of talent. The Abu Dhabi programme for works being a particular beacon for the market. With significant early and mid-stage planning already underway, the pickup could well outstrip contract award forecasts if decisions can be made in an expeditious manner. The future will be growth in a market that has been stagnant or declining. So long as the supply chain can manage their risks and banks can manage a return to lending to the industry - another issue in the market as regional banks are over exposed to the market as a percentage of GDP to coverage - there should be a manageable route through. ●

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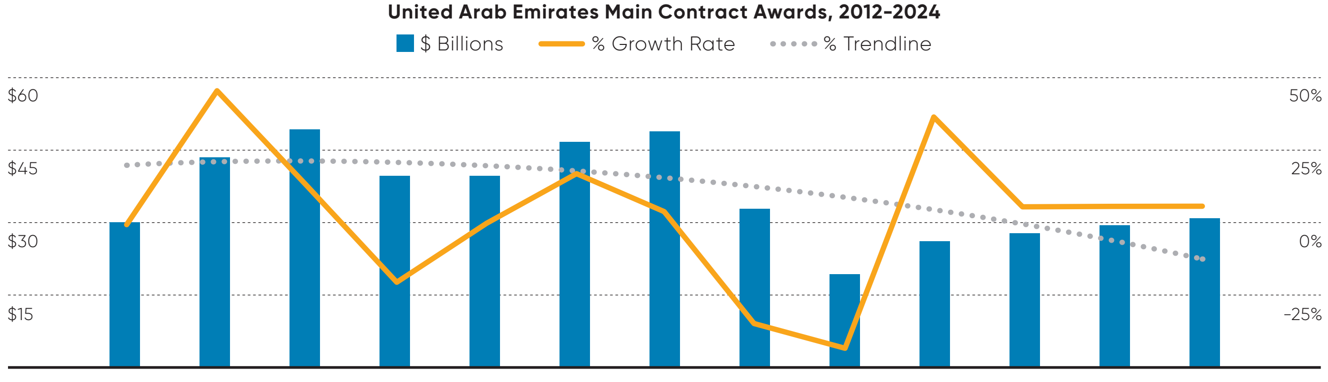
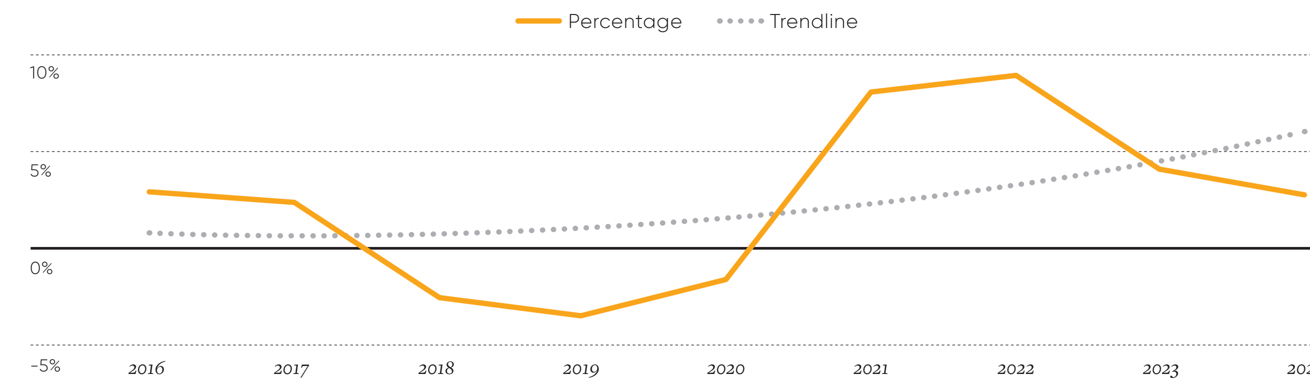
United Arab Emirates Main Contract Awards, 2012-2024



United Arab Emirates Construction Inflation, 2016-2024



Rebar - Landed Cost Per Tonne, Q1 2020 - Q4 2021