Renewed vigour in South Africa and Kenya as economies recover from their respective slowdowns.

“Tender prices dropped towards the end of 2017 due to adverse weather conditions, political uncertainty and credit growth stagnation. However East African economies are expected to see an expansion in the communications, mining and oil exploration sectors in 2018, along with significant investment in public infrastructure. This, combined with increasing material prices, are expected to push tender prices back up.”

Simon Herd
Managing Director MaceYMR

“With the hopes of renewed vigour in the government’s approach to tackling corruption, and reforming the beleaguered economy, South Africa has seen some optimism return to the construction market. However, with future pipelines held back by slow growth, and inflation dropping off, tender costs could see deflationary pressures over the next six months as contractors look to secure what work they can after the recent slowdown.”

Mandla Mlangeni
Director for MMQSMace

**Growth figures**

<table>
<thead>
<tr>
<th>2017 GDP GROWTH</th>
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<tbody>
<tr>
<td>5%</td>
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<tr>
<td>Kenya</td>
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<table>
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<tr>
<th>2022 GDP GROWTH</th>
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<tr>
<td>6.5%</td>
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<tr>
<td>Kenya</td>
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**Forecast movement of inflation and currency value**

Kenya
- Inflation: stable
- Exchange rate: slowing

South Africa
- Inflation: slowing
- Exchange rate: slowing
**EXECUTIVE SUMMARY**

Similarly to other regions, Africa is forecast to enjoy a rebound in growth across the Continent, driven by investment in infrastructure, expansion of oil production to new areas and improved weather conditions after some years of drought conditions. Infrastructure projects in particular continue to be in the spotlight, particularly in East Africa where regional transport integration continues apace, providing plenty of opportunities for expansion of construction in this region.

Both South Africa and Kenya had challenging years, for very different reasons. South Africa is in gradual recovery from the recessionary conditions experienced in the first half of the year, and the election of Cyril Ramaphosa as ANC leader is hoped to inject some much needed optimism into the market, kick-starting the struggling construction industry. The South African government faces a particular challenge in balancing the need to restore fiscal credibility with the need to boost the economy. Kenya on the other hand continues to see significant return on its investment in transport, energy and social infrastructure, but has recently experienced an economic slowdown, largely driven by heightened political tensions in the run up to (and during) the protracted elections of H2 2017. However, with strong fundamentals Kenya, and its construction industry, are forecast to return to strong growth in 2018.

**SOUTH AFRICA INFRASTRUCTURE FUELING DEMAND**

Across the African continent an economic rebound is expected in 2018, driven by recovery in the big players’ economies (including South Africa and Nigeria) and ongoing growth in top performers, including Ethiopia and Ghana. New investments in oil production, strengthening infrastructure investment across East and West Africa and improved weather conditions are all factors likely to contribute to the anticipated rebound. These represent particular opportunities for the construction industry, with a huge selection of infrastructure projects to work on and growing gas and oil construction demand.

Infrastructure, and in particular massive, often regional and externally funded transport and energy projects continue to be in the spotlight in 2018. Examples include the Nigeria transport network, which is due for a 12 station, 28 mile boost with the launch of Abuja light rail. Ethiopia’s Ababa-Bole International Airport is expected to complete in 2018, and Uganda will open its largest power plant, one of the continent’s largest hydropower facilities. These large scale projects are being funded by increasingly diverse sources: as the US looks to pare down its foreign aid budget, Turkey and other countries could increasingly challenge China’s position in Africa, with some recent high value wins for Turkish contractors in East Africa.

The African Union is looking to boost passage of goods, people and services between borders through the Continental Free Trade Area (CFTA) this year, providing spurring growth and development among member states. This could provide further boosts to recovering economies, and drive stronger performance even than anticipated.

**CONFIDENCE & CREDIBILITY BOOST NEEDED FOR CONSTRUCTION**

The South African economy is still in recovery mode from the various shocks faced throughout 2015 and in H1 2017. At only 0.7% for 2017, the level of economic growth is currently insufficient to meet the country’s development aspirations, and the slow growth is placing significant pressure on the fiscal framework. The economy is now expected to start to recover, slowly, reaching growth rates of 2.2% by 2022. This year’s marginal recovery has been concentrated in three sectors, namely agriculture, mining and manufacturing, however the slow momentum coming into 2018 means that we are likely to see a second consecutive year of falling per capita income, and therefore weak demand.

However, the election of a new leader of the ANC has injected optimism into an economy lacking in confidence. Deputy President Cyril Ramaphosa plans to target 3% growth by 2018, and 5% by 2023, and to create 1m new jobs within the next 5 years. The new leader, likely to win the presidency in 2019 elections, faces a daunting task: rebuilding an economy battered by years of mismanagement and the influence of corruption. At current forecast rates of growth the economy is not creating enough new jobs to address the structural issues in the South African labour market, including widespread poverty and severe unemployment (at a 14 year high of 27.4%). This feeds through into a circle of weak domestic demand leading to slowing growth, and more unemployment: the state hopes significant investment in apprenticeships and large scale infrastructure investment will be enough to break this cycle and start getting the population into formal work.

His stated goals include taking urgent measures to repair investor confidence, through improving institutional stability, restoring the credibility of the criminal justice system and demonstrating the state has the political will to turn the country’s finances around. But credibility is hard to rebuild, and it will take considerable time for the damage done to South Africa’s international and domestic investor confidence and reputation to be restored, making the 3% growth target in 2018 very ambitious.

The dual need to restore credibility and invest in the economy is challenging, as the government has little wiggle room for expansionary spending to boost jobs, but needs to convince investors and currency markets they are reigning in their spending. Debt service costs are now the fastest growing segment of the budget, nearly 15% of the budget now compared to a low of 8.6% in 2003/4, underlining the need for fiscal discipline. As such we hope to see prioritisation of the most high impact projects for government investment, and an expansion of private sector funding across sectors, in order to ensure the ambitious pipeline of infrastructure work outlined by the South African government gets built.

**RAMAPHOSA TO BOOST INFRASTRUCTURE**

A $46bn infrastructure investment gap has been identified in South Africa, with a need for investment into the water and electricity sectors to plug this gap and address anticipated population and economic growth. Without this investment, it has been suggested they will not be able to meet their United Nations Sustainable Development Goals. Investing in the right areas to boost growth as well as provide the essential services the growing population needs will be key going forward, and for South Africa a challenge between restoring fiscal confidence and spending the money needed. As it stands, they are forecast to meet only 66% of their infrastructure needs by 2040.

Fortunately, support to the construction market will be provided in the form of further boosts to infrastructure spending, compensating for the volatility in the buildings pipeline. Spending on new roads, power stations and ports as well as other capital projects will be boosted to 1.5% of GDP over the next 5 years under Ramaphosa, providing a platform for growth in this key sector.
The latest readings for material inflation in South Africa show some strengthening since the low point for 2017 in August of only 3.1%, returning to more historically normal 4.7%. However 2017 has reflected a significant pick up in materials inflation compared to previous years, and we are likely to see this feeding into tender price inflation through to 2018. At 4.4% average materials inflation in 2017 compared to 1.3% in 2016 and only 0.3% in 2015, this cost has jumped up in the past year and represents a potential risk to profit margins if increased cost cannot be passed through to tender prices in the challenging current environment.

Wider producer price inflation has shrunk to less challenging levels of 5.1% in November 2017, alongside a similar slowdown in consumer price inflation from highs of 7% in February 2016 (driven by a large currency depreciation) to 4.6% now, safely within the 3-6% target of the South Africa’s Rand saw a significant appreciation in 2017 which contributed to bringing down inflation, but negatively impacted external demand adding to the economic woes of the country in this challenging year. However, this appreciation is not expected to be long lasting, with anticipation that the Rand will depreciate steadily through to 2021 from today’s value 13.37 to the US$ to 15.82 in 2021.

The effect of recent uncertainty and shrinking pipeline in the construction sector can be seen in the trajectory of construction earnings compared to the wider economy. Previously growing at a significantly higher rate than average earnings (a full 4.9% faster growth of 15.4% in q2 2016), as activity has slowed we have seen a reversal of this, shrinking to 5.8% less strong growth than national average at only 0.2% growth in q3 2017. Whilst this is positive in terms of labour costs, it also indicates that the construction sector is suffering the effects of the ratings downgrades and challenging economic outlook more strongly than the wider economy, whose earnings growth has slowed, but only by 4.5% as compared to construction’s 15.2% slowdown in the same period. Keeping talent in the industry and ensuring capacity to complete the full infrastructure pipeline will become more challenging the less attractive earnings appear as compared to other industries, however with a large unemployed labour pool there will be plenty of unskilled labour supply for years to come.

KENYA LEADER OF THE PACK

Kenya is seeing significant returns on recent investment in transport, energy and social infrastructure. In 2006 Kenya’s GDP per capita was close to the African average: fast forward just over ten years and it has grown to half again the current average at $1,455 per person, a huge bound in terms of standards of living. With a rapidly growing and urbanising population, Kenya is expected to overtake the Netherlands in terms of urban population by 2025, driving the need to keep up with the growing population and their transport, energy, housing and community needs, and hence ongoing investment by the government. Between this and the strong underlying fundamentals in Kenya’s economy we are likely to see stable domestic demand continuing to drive steady growth in construction over the next decade.

STRONG DEMAND FOR INFRASTRUCTURE DESPITE ELECTORAL SLOWDOWN

Despite all this economic growth decelerated in Kenya in the latter half of 2017 to 4.4% in q3, compared to 5.6% for the same period in 2016, largely due to the uncertainty creeping into the economy from the protracted (and expensive) national elections. Together with adverse weather conditions, lower investment due to this uncertainty slowed growth, despite stable fundamentals. This slowdown is unlikely to last long however: Kenya is developing rapidly and ongoing improvement in economic and business conditions will drive this development further. In 2016, Kenya was the 3rd most improved country in the ease of doing business rankings. And they have become the 2nd most attractive Foreign Direct Investment destination in Africa after Morocco in 2016. Positioning itself as the gateway to East and Central Africa with the growing Port of Mombasa increasingly the main transport and logistics hub to African countries in the region, Kenya is investing in the right places to combat any slowdown. After the dip in 2017, economic activity is expected to pick up, growing to more than 6% growth per year by 2019, and supporting ongoing strong demand and activity in the construction industry.
Infrastructure construction has seen significant growth and investment in Kenya in recent years, growing 9.3% to q3 2016, on top of strong 15.6% growth in the same period in 2015. The government is focusing on improving transport infrastructure, both in terms of domestic and international links, and is striving to facilitate ease of doing business with port, road and rail network expansion plans ongoing.

Substantial government spending on infrastructure as well as foreign investment flows are sustaining this high level of growth, however in the run up to the elections in 2017 some spending was put on hold, creating a drag on construction growth as a whole. Significant investment in roads is planned, with KES134.9bn set aside for new roads and maintenance. Add to that ongoing development at Mombasa and Lamu port, airport expansions/development across the country and more than KES327bn spent on Standard Gauge Railway development, and a picture of ongoing strong demand for infrastructure construction clearly emerges.

In seeking to improve its international connections, Kenya is also benefiting from investment at the regional level into links, and is striving to facilitate ease of doing business with port, road and rail network expansion plans ongoing. Substantial government spending on infrastructure as well as foreign investment flows are sustaining this high level of growth, however in the run up to the elections in 2017 some spending was put on hold, creating a drag on construction growth as a whole. Significant investment in roads is planned, with KES134.9bn set aside for new roads and maintenance. Add to that ongoing development at Mombasa and Lamu port, airport expansions/development across the country and more than KES327bn spent on Standard Gauge Railway development, and a picture of ongoing strong demand for infrastructure construction clearly emerges.

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Fig. 10: Annual change in cost to Q3 2017 - BER data

- Lump sum preliminaries: 4.8%
- Commercial or industrial buildings: 4.5%
- Lump sum domestic buildings: 6.5%
- Steel water pipe installations: 3.8%
- Refrigerations installations: 5.3%
- Ductwork installations: 6.8%
- Mechanical services: 3.7%
- Electrical rectification: 3.1%
- Electrical installations: 10%
- Roadwork: 3.3%
- Painting: 11.4%
- Glazing: 2.6%
- Aluminium shop fronts and preglazed windows: 3.4%
- Plumbing: 5.3%
- Drainage: 4.6%
- Tiling: 5.1%
- In situ finishes: 5.2%
- Stainless steel work: 3.4%
- Aluminium work: 3.9%
- Partitioning systems: 1%
- Metalwork: 2.7%
- Structural steelwork in buildings: 3.9%
- Ironmongery: 2.3%
- Resilient floor and wall coverings: 3.6%
- Ceilings: 6.8%
- Carpentry and joinery: 1.6%
- Metal roofing (aluminium): 2.2%
- Metal roofing (steel): 3.4%
- Non metal roofing: 4.6%
- Water proofing: 1.9%
- Masonry: 10.9%
- Brick and block work: 11.3%
- Reinforcement: 3.1%
- Post tensioning: 7.8%
- Precast concrete: 10.5%
- Formwork: 5.0%
- Concrete (excluding formwork): 8.0%
- Piling: 3.1%
- Earthworks: 5.2%
- Alterations: 3.1%

Source: Stats SA
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