CONSTRUCTION'S COSTLY REALIGNMENT

Between 2004 and 2008 the rising price of construction materials in general gathered pace; but there were signs in the building supply industry that the rises were not sustainable. Frank Richardson takes a retrospective look in order to throw some light on a global realignment of prices in the industry.

A year can be a short time in the building material industry. A few months ago the rise in the price of building materials seemed inexorable. The rises became steeper as the apex loomed, with truly dramatic increases occurring for carbon-based products and steel. Higher energy prices was one of many factors behind this; but the most significant factor in the steel market was China's international demand for scrap metal used in the production of the almost 40% of the world's steel products it consumed. Then the fallout of bursting property price bubbles and squeezed credit around the world took its toll and we now have a supply glut and price collapse.

The steep climb

In the Middle East, India and China, where the lion's share of the world's construction was located, rapidly rising costs meant developers counted heavily on matching rises in property prices to maintain their profit margins of between 30 and 100%. The spiralling cost of construction materials was particularly evident, for instance, in the Gulf Cooperation Council (GCC) countries, where building and infrastructure development on a huge scale was well under way. High oil prices, increased freight costs, the falling dollar and log cutting restrictions imposed by countries in south east Asia, only abetted the trend. During 2007, the price of building materials in GCC countries soared by 30%. In the first quarter of 2008, white-wood prices jumped by 20% and aluminium prices by almost 23% and, as things came to a head over the first half of 2008, the price of cement rose by a remarkable 50% and steel by 70%.

Concerned about market manipulation, the growing number of project disputes and inflation resulting from the sharply fluctuating prices of building materials in the UAE, the Abu Dhabi authorities established a building materials price index as a counter measure. The index showed that, while some steel products increased in price by as much as 19% in June, 2008, other materials had, in fact, started to decline by 30%. This was, perhaps, the writing on a wall that had, itself, become too costly.

Europe was not enjoying a construction boom of anything like the same magnitude; but we can, from the Irish CSO Wholesale Price index, gain some idea of the extent of the price rises there for building and construction materials prior to the bursting of the credit-fuelled property price bubble. In 2006 oil-based products such as bituminous macadam, asphalt and bituminous emulsions increased in price by as much as 16.1% and by 11% in the first half of 2007. There were similar increases in the prices for cement and timber.

On the other side of the world, a similar index produced by the Australian Bureau of Statistics indicates that while the price of concrete, cement and sand products increased on average by 3% between 2005 and 2007, this rose to 7.6% between 2007 and 2008, with similar increases evident in the price of timber. Significantly, the respective figures for steel were 4% and 36.5%, and for carbon-based products they were -0.6% and a massive 41.31%.

The slippery slope

The bursting of the U.S. mortgage bubble, as a result of the sub-prime fiasco, not only hit American banks, but also impacted on banks in Europe, where it popped the fragile property price bubble that was fuelling consumption. The ripples of recession have since spread beyond the G7 countries to net commodity importers and hydrocarbon producing countries. Even China's growth is slowing and building material prices are falling in the wake of the downturn.

In the U.S., because lenders adopted a far more cautious approach and tightened their lending criteria, home prices slumped by 20% in 2008, with another drop of 10% expected in the first half of 2009. As a consequence, the number of family housing units being constructed is predicted to fall in 2009 by about 6%; but, more worryingly, electric utility, retail and manufacturing building construction are expected to decline by a massive 30% or more. The dimension stone market (granite, marble, slate and other stone used in construction) is just one example in an industry that showed signs of a slowdown in the U.S. as early as 2006. The price of granite, for instance, compared with four years ago, has more than halved because suppliers drove down prices by competing fiercely for what business there was, while, at the same time, stocks of granite were being offloaded as finance became scarcer due to the credit squeeze. The story of timber is similar, with prices falling in 2007 by 40% compared with a year earlier, as price bubbles in the U.S. deflated, ahead of those in the global market fragmented by high transportation costs.

In the U.K. construction industry, it is the housing market that is now being worst hit; ↘

but activity in the commercial and civil engineering sectors is also declining dramatically. The Construction Purchasing Managers' Index (PMI), fell from 31.8 in November to 29.3 in December, making it the 10th successive month that the index was below the 50 mark, indicating market contraction.

In the Far East, building material prices in the Philippines had dropped by an average of 40% by the end of 2008, with developers, fearful of failing to find purchasers for their buildings, adopting a "wait and see" approach and expecting a construction slowdown in 2009. Many contractors have substantially reduced their inventories and are buying day-by-day, rather than month-by-month, in order to take advantage of the fall in prices.

Turkish construction companies operate in a number of countries around them and, therefore, act as a good barometer for gauging the health of construction in the region. Russia has evidently been hit hard by the financial crisis, with construction projects being postponed or cancelled, leaving Turkish workers without work. Turkish companies are experiencing similar problems in Kazakhstan and Azerbaijan and now, increasingly, in North Africa and the Gulf region.

In the GCC countries, in hindsight, the mid-2008 decline in some building material prices was an indication of growing unease in the construction industry, that saw site owners reconsidering some of their gargantuan projects because of supply fears and concerns that property prices might not rise fast enough to cover rapidly rising costs. As demand for steel in major economies fell, October 2008 saw a fall in the cost of building materials in the Gulf. The price of UAE-made steel bars dropped by 23% and Turkish high tensile steel plummeted by 31%. An increase in steel production in local markets, that was driven by cost reductions due to falling oil prices, lower shipping costs and a reduction in the price of iron, reinforced the decline, and similar factors brought down the price of cement.

A recent report by a leading Islamic investment bank, Gulf Finance House, confirmed that the global financial crisis is likely to slow the economies of the GCC nations, leading to a slump in demand for building materials and, therefore, a decline in their price because of excess capacity. Although the economies of these countries remain fairly resilient, the report contends that only a continuation of the massive injection of investment in GCC projects, foreign capital flight curtailment and the maintenance of adequate fiscal and current account surpluses through the price of oil remaining above US$60, are likely to alleviate the downturn. Oil prices, though, have since collapsed to less than US$40 a barrel, from the record highs of more than US$147 in July, and already in Dubai, for example, prices of homes have started to fall, with property developers and construction companies laying off thousands of workers.

Redemption

All, though, is not gloom and doom. It is evident that the extent to which Asian countries are suffering is proportionate to their level of export dependency; whereas the Middle East and Latin America are cushioned, to a degree, by their significant foreign currency reserves, fiscal surpluses and focus on infrastructure construction. Consequently, construction projects that were put on the back-burner because of sky-rocketing building material prices, may now come back on stream as their viability returns because of relatively lower building material prices. As the price of oil partially recovers, therefore, it could be the GCC countries that will be the ones to help kick-start a realigned construction industry. □