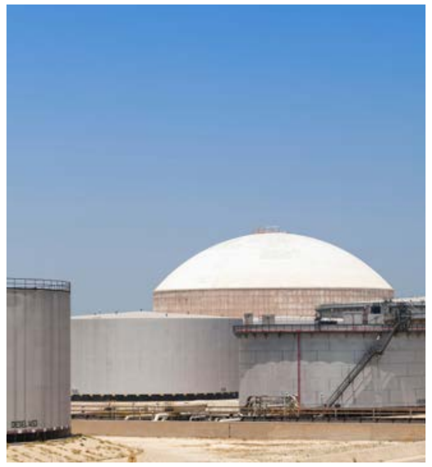
RESEARCH

MARKET INSIGHT

WHAT ARE THE LIKELY IMPLICATIONS OF LOWER OIL PRICES FOR REAL ESTATE IN THE GCC?

DECEMBER 2014

Lower oil prices are leading many in the GCC to wonder about the possible implications for real estate. In the near-term, weaker sentiment and its impact on the residential property sector is the principal downside risk. Commercial property however should be able to shrug off such concerns as the region's medium to long-term prospects remain strong.



After hitting nearly US$108/barrel in June, the average Organization of Petroleum Exporting Countries' (OPEC) reference price fell to just under US$76/barrel last month. (See Chart 1.) Despite the sharp fall though, OPEC decided to leave its output ceiling at 30 million barrels per day (b/d) at the meeting in Vienna last month – a notable departure from its traditional stance of cutting production in order to prevent prices from sliding further.

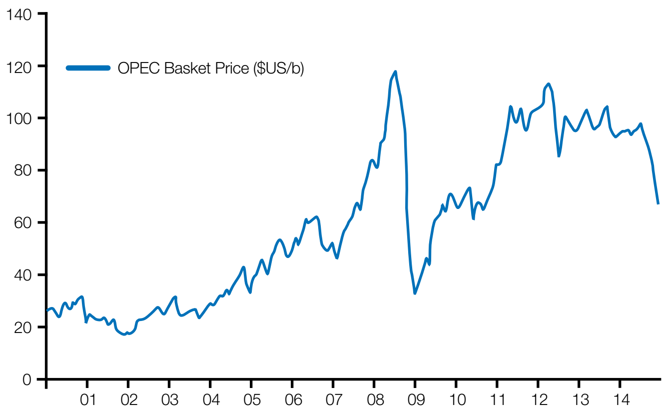
In context of this, how has the non-hydrocarbon sector performed? According to Markit, the seasonally adjusted UAE and Saudi Arabia Purchasing Indices (PMI) remained well above the 50-no change mark in November – pointing to healthy expansion in the markets' private non-oil sectors. (See Chart 2.) This is positive news for real estate, not least because the non-hydrocarbon sector is an important source of demand for property owners in the GCC.

Also, in the short to medium-term, the expectation is that GCC governments will not cut back on current levels of spending, even if oil prices fall further and budgets slip into deficit. After all, these states have accumulated substantial surpluses over the past decade, leaving them in a position to be able to finance deficits for some time to come, according to Emirates NBD research. Notably, Saudi Arabia has vast foreign currency reserves to fall back on.

This is important given that large publicly funded, infrastructure-related schemes tend to stimulate hinterland construction activity, and thus support growth in the real estate sector. And there is plenty scheduled to be built. According to a recent report by Ventures Middle East, the total value of contracts awarded in the GCC is projected to rise to approximately US$196bn this year, from almost US$160bn last year – an annual increase of 22%.

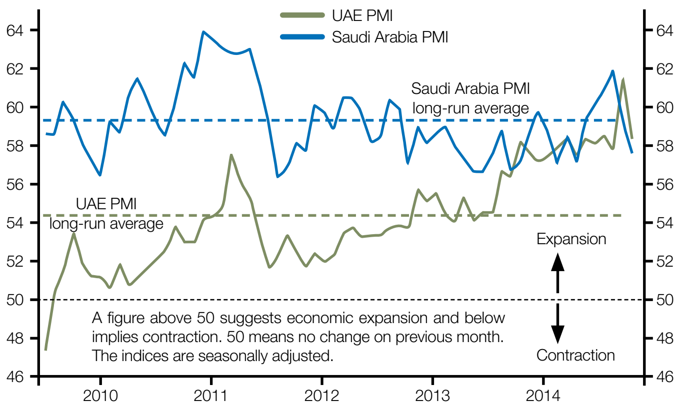
Moreover, the IMF recently predicted that a 30% fall in oil prices will provide

FIGURE 1
Oil Prices



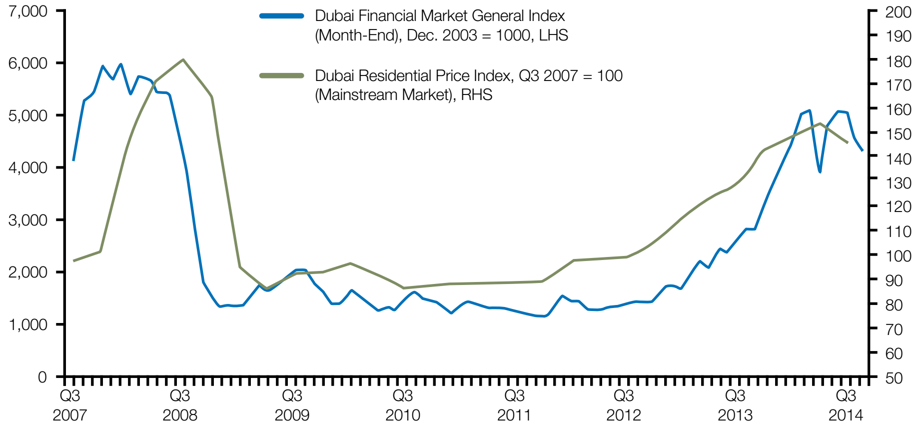
Source: Bloomberg

FIGURE 2
UAE and Saudi Arabia Purchasing Manager Indices (PMI)



Source: Markit

FIGURE 3
Dubai Financial Market and Dubai Residential Market Indices



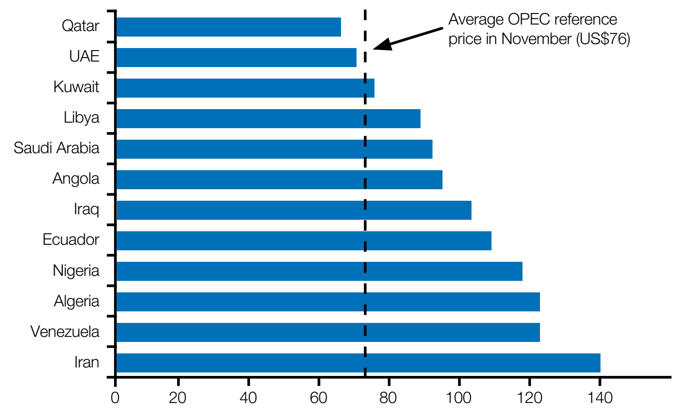
Sources: CEIC, Knight Frank

an additional 0.8% boost for most advanced economies (who are typically net importers of oil). This in turn should have a positive wealth effect, with some resultant capital flows likely to benefit those real estate markets already popular with foreigners; an obvious example in the GCC is Dubai, where in H1 2014, around three-quarters of real estate investors were non-nationals.

But that does not mean to say that there aren't any downside risks. Dubai, Abu Dhabi, Qatar and Oman's bourses have all recently suffered losses on the back of falling oil prices. The softening in investor sentiment however isn't likely to be reflected in just equity prices. Historically, there has been a reasonably strong correlation between the Dubai Financial Market General Index (DFMGI) and residential property prices; if this relationship holds, home prices in the emirate should continue to trend down in Q4 2014. (See Chart 3.) Commercial property though should be relatively resilient given that firms tend to take a medium to long-term view – which continues to look positive for the GCC – when launching expansion plans.

Over the next few years, with government spending in the GCC unlikely to be curbed, infrastructure construction activity should provide a strong basis for growth in the real estate sector. That said, weaker sentiment stemming from lower oil prices may act as a drag on residential prices in the near-term.

FIGURE 4
Estimated Oil Price Needed to Balance 2014 Government Budgets (US$)



Sources: Libyan Government, Angolan Ministry of Finance, IMF, Arab Petroleum Investments Corp., Deutsche Bank

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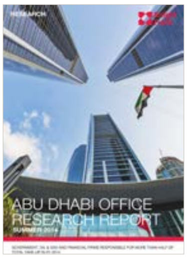

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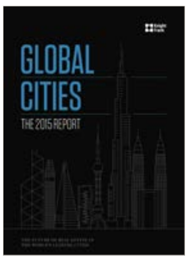

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