THE CONSTRUCTION SECTOR AT CROSSROADS

MIERSCOPE

by

Elayne Yee

From the late 1980s to the mid-90s, the construction sector had played an important role in development of the Malaysian economy. Through the creation of fixed assets, the construction sector complements the other sectors in the economy by providing a basis for generating output, income and employment, all necessary ingredients for promoting economic growth.

However, the property sector has always been highly sensitive to economic ups and downs everywhere, with property prices soaring during boom times and melting during slumps. It is also capable of contributing to the boom and bust cycles through over-construction when the economy is soaring. It can weaken the country's balance of payments, not only by diverting resources from the production of tradable goods and services, but also by increasing the import bill as construction tends to be import-intensive. Falling property prices can cause problems for financial institutions which use properties as collateral. Experience elsewhere has shown that a collapse of the property market can even lead to severe outcomes including bank failures. But the property market is cyclical and it is not bad all the time. There are good times when players are well-rewarded. Containing valuable information, the property cycle is an indispensable tool for making predictions.

The growth trend of the construction sector has almost always moved in consonance with that of the gross domestic product (GDP), although the former demonstrates more volatility. Prior to the 1998 Asian economic crisis, the construction sector has grown considerably, particularly since 1990. There was an unprecedented and sustained economic boom that commenced in 1987 and ended in 1997 during which the property market characteristically was in overdrive. The construction sector grew rapidly at 13.4 per cent per annum during 1990-1997 (pre-crisis period) arising from the active property market and accelerated development of infrastructure projects. It then plummeted drastically in 1998 to register a growth of –23 per cent, due to the Asian crisis which slumped the Malaysian economy into a severe recession.

But since 1998, efforts undertaken by the government and private sector to revive the industry, particularly the lowering of interest rates, Home Ownership Campaigns and the resumption of several infrastructure projects helped turn the sector around, enabling it to recover albeit slowly after 1999. The effect of these initiatives was consequently observed in the third quarter of 1999 when growth in this sector was at 4.6 per cent.

However, the construction industry's share to total GDP is generally small. Its share to total GDP was only 4, 3.6, 3.4 and 3.3 per cent in 1998, 1999, 2000 and 2001, respectively. This is not surprising, as the construction of infrastructure, as explained earlier, has been the onus of government strategy in pump-priming the economy through budget deficits. The fact, however, remains that construction activities in general were a part of the problem behind the financial crisis. The broad property sector accounted for 31.4 per cent of bank loans in 1996. In addition, bank loans in this category were growing at a rapid 29.7 per cent per annum during 1995-96.

What is surprising is that the picture has not changed much since the outbreak of the crisis. In fact, the share of the broad property sector in total bank loans has actually increased from 33.2 per cent in 1997 to 37.8 per cent in September 2002. Curiously enough, bank loans to the property sector continued to surpass overall loans growth. But this is not good enough as long as the property market overhang continues. Then again, the property market represents a mixed basket with industrial, commercial and residential units with different supply and demand equations.

Although the construction industry's share to total GDP seems small, the construction industry is still an important contributor to the general health of the economy as it acts as a catalyst for, and has strong linkages with, a wide range of economic activities in the country. According to the Economic Report 2002/2003, construction-related industries are expected to benefit from the on-going implementation of fiscal stimulus projects as well as sustained performance of the housing sub-sector. For the first half of 2001, cement and concrete recorded a positive growth of 13.1 per cent, while the production of ceramic and tiles expanded by 4.1 per cent. And currently, the non-metallic mineral industry, especially the ceramic sub-sector is operating above capacities of 80 per cent.

Second to non-residential projects (40 per cent), in 2001, the share of infrastructure projects to the total costs of construction projects was 37 per cent, which amounted to RM18.3 billion, while residential projects comprised 19 per cent (RM9.12 billion), maintenance 2 per cent (RM1.19 billion), and mix development the remaining 2 per cent (RM0.9 billion). Clearly, infrastructure projects have contributed quite positively to the country's economic growth. As a result, the construction industry achieved positive year-on-year growth of 2.9 per cent in first quarter 2002 and 3.4 per cent in second quarter 2002, with quarterly GDP growth of 1.1 and 3.8 per cent, respectively. The massive repatriation of foreign labour recently had adversely impacted the sector in the third quarter. However, construction activity in the non-residential sub-sector remained subdued, constrained in large part by the huge property overhang in office and retail space. Again, these sub-sectors are easy targets for pressures stemming from both global and domestic economic concerns.

On the whole, the construction sector looks generally tame throughout 2002. The current indolence in the property market was due to the flagging global economy spurred by an unfavourable US economy, weak sentiments and the weak stock market at home. The year 2002 carried with it much of the excess baggage from the previous year and the market is likely to trudge along for early 2003 as well. While the residential sub-sector provided some buzz, the other segments remained generally lethargic, pressured by oversupply and economic conditions. This is because performance in the property sector, as explained earlier, tends to mirror GDP growth.

Looking ahead, the residential sub-sector is likely to continue to breathe life into the property market. Unless the economy takes a turn for the worse, prospects for this sub-sector look likely to remain resilient. Still, even this "star performer" has its share of downside risks. One of them is developers' concentration on affordable homes, which may exacerbate the current overhang problem. According to the latest National Property Information Centre's (NAPIC) Property Overhang Report, a total of 43,541 housing units remained unsold as at March 2002. Of these, 72.8 per cent were priced at RM150,000 and below.

Meanwhile, pessimism continues to loom over the other sub-sectors of purpose-built office, shopping complex and industrial space. Poorer take-up arising from delayed expansion plans or business contraction coupled with looming supply often results in a prolonged absorption period. Clearly, there is no cause for celebration in these sectors until the global economy rebounds and business sentiments improve which will help push for higher demand for office and industrial spaces.

Due to uncertainties in the global economy, any positive outlook of the construction sector and the building industry will, to a certain extent, be contingent upon the growth cycle effects of the Malaysian economy and, hence, the impact of the international economic environment. At the same time, Malaysia is entering a more competitive environment, for which we need to be even more prepared with adequate investment in human and physical capital formation. Constant innovation and focus on quality are the keys to the evolution and growth of the industry that must meet the needs of a developing nation where people are also reinventing themselves, as they gain greater exposure in the face of globalisation and liberalisation.

All in all, there should be concerted effort from all industry players. They each have their role to play as regulators, service providers and end-financiers, but speed and professionalism are the essence. All parties should monitor and rejuvenate the industry, but the pace of market recovery is best left to market forces as market forces will allocate resources and provide long-term solutions to the industry better than any covert regulated action. Since most of the fallout from the crisis has been contained, perhaps it is more appropriate for regulators to concentrate more on providing crucial and timely information to industry players so that they can make better-informed decisions in the future.

Elayne Yee Siew Lin is a Senior Research Officer with the Malaysian Institute of Economic Research (MIER)